

# THE INDONESIAN QUARTERLY

## Indonesia's Economic Policy Reforms

- Current Events
- Structural Adjustment in Indonesia:  
Export and the "High-Cost" Economy
- Economic Policy Reforms in Indonesia
- Recent Changes in the World Economy:  
Adjustments in Selected Countries
- Party Conflicts under the New Order:  
Patterns and Tendencies
- Australia and Its Strategic Position in the  
Asia-Pacific Region
- Book Reviews



## The Quarterly

*The Indonesian Quarterly* is a journal of policy oriented studies published by the Centre for Strategic and International Studies (CSIS), Jalan Tanah Abang III/23-27, Jakarta 10160. It is a medium for research findings, evaluations and views of scholars, statesmen and thinkers on the Indonesian situation and its problems. It is also a medium for Indonesian views on regional and global problems. The opinions expressed in *The Indonesian Quarterly* are those of their authors and do not necessarily reflect the opinion of the CSIS.

## The Logo



To better represent the underlying ideas that gave birth to the CSIS in 1971 the Centre uses as of 1989 the logo that figures on the front cover of this journal. The original, in bronze, designed by G. Sidhartha, it consists of a disc with an engraving that depicts the globe which serves as a background to a naked man with an open book laid on a cloth over his lap, his left hand pointing into the book, his right hand raised upwards. Altogether it symbolises the Centre's nature as an institution where people think, learn and communicate their knowledge to whoever are interested, to share it with them, mankind the world over being their concern and the globe their horizon. The nakedness symbolises the open-mindedness, the absence of prejudice, in the attitude of the scholars who work with the Centre, just as it is with scholars everywhere. The inscription reads "*Nalar Ajar Terusan Budi*," which in the Javanese language essentially means that to think and to share knowledge are only the natural consequence of an enlightened mind. It is a *surya sengkala*, that is *chandra sengkala*, a Javanese traditional way to symbolise a commemorable year in the lunar calendar, adapted to the solar calendar system. It consists in using words that express the perceived meaning of the commemorated year while marking the year at the same time, each word having a numerical value. Thus, the inscription, in reverse order, represents the year the CSIS was established: 1971.

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# THE INDONESIAN QUARTERLY

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## From the Editor

**I**NDONESIA'S ECONOMY has come out of the turbulent first half of the 1980s with some strength. The country is certainly one of the ASEAN states whose success in overcoming the difficulties of that period has been referred to by Djisman S. Simandjuntak in an earlier issue of *The Quarterly* as providing "reasons to believe in the ability of the peoples, governments, intellectuals, business communities and other elements of the community ... to adjust to changes that are likely to confront them while entering the 1990s"<sup>1</sup> and to deal with problems of unemployment and poverty that persist.

In this third quarter issue, M. Hadi Soesastro, in "Current Events," makes a brief overview of Indonesia's economy based on data available in July. Ali Wardhana, one of the architects of the country's economic development, gives, in "Structural Adjustment in Indonesia: Export and the 'High-Cost' Economy," an account of the measures that have been taken by the government and have resulted in the success. The article includes the reasoning behind the measures, the particular circumstances that have been taken into consideration and the policy tools that have been used. It is followed by "Economic Policy Reforms in Indonesia," in which Mari Pangestu basically analyses the same subject but as seen from outside the government and which seems therefore to be less inhibited in mentioning some, mostly political difficulties facing the government's economic team, particularly during the oil boom years of 1973-1982.

After those reviews that focus on Indonesia's economic management, the readers might find it interesting to go along with Djisman S. Simandjuntak in exploring the world, in "Recent Changes in the World Economy: Adjustments in Selected Countries," to identify the changes that constitute what he terms a "highly uncertain global economic environment," the adjustments of the major economic to those changes and the problems that remain.

Then, in "Party Conflicts under the New Order: Patterns and Tendencies" the readers are brought back by Sjamsuddin Haris to Indonesia, not to its economy but to its political realm instead. This analysis is interesting not only for the very subject it treats but also for its being rich in information that would be useful to those who are interested in the development of democracy in the country.

<sup>1</sup>Djisman S. Simandjuntak, "Instability of Global Environment and ASEAN Economic Co-operation," in *The Indonesian Quarterly*, Vol. XVII, No. 1, First Quarter, 1989.

The last article, "Australia and Its Strategic Position in the Asia-Pacific Region," has been specially prepared by Michael O'Connor, an Australian analyst who obviously believes in the good relationship between his country and its vast archipelagic neighbour directly to its north, for publication in this Indonesian journal of policy oriented studies. This article has apparently been written in response to views on his country's intentions in Southeast Asia that were expressed in The Fifth Australia-Indonesia Conference held at the Australian National University in May this year, which he sees as the result of "an imperfect understanding of the basic strategic imperatives upon which Australia must construct a security policy."

*J. Kadjat HARTOJO*



## Current Events

# A Brief Overview of the Indonesian Economy July 1989

*M. Hadi SOESASTRO*

### Brighter Prospects for the Indonesian Economy

**T**HE INDONESIAN economy appears to be heading towards a much stronger recovery than expected even a few months ago. Unemployment and debt issues remain as serious as ever but there is greater confidence on the part of many that the economy has overcome the worst. The official estimate of economic growth for 1988 is far from disappointing, with the economy (GDP) growing by more than 5 per cent. One source suggests that economic growth in 1989 will be about 5.4 per cent or better.<sup>1</sup>

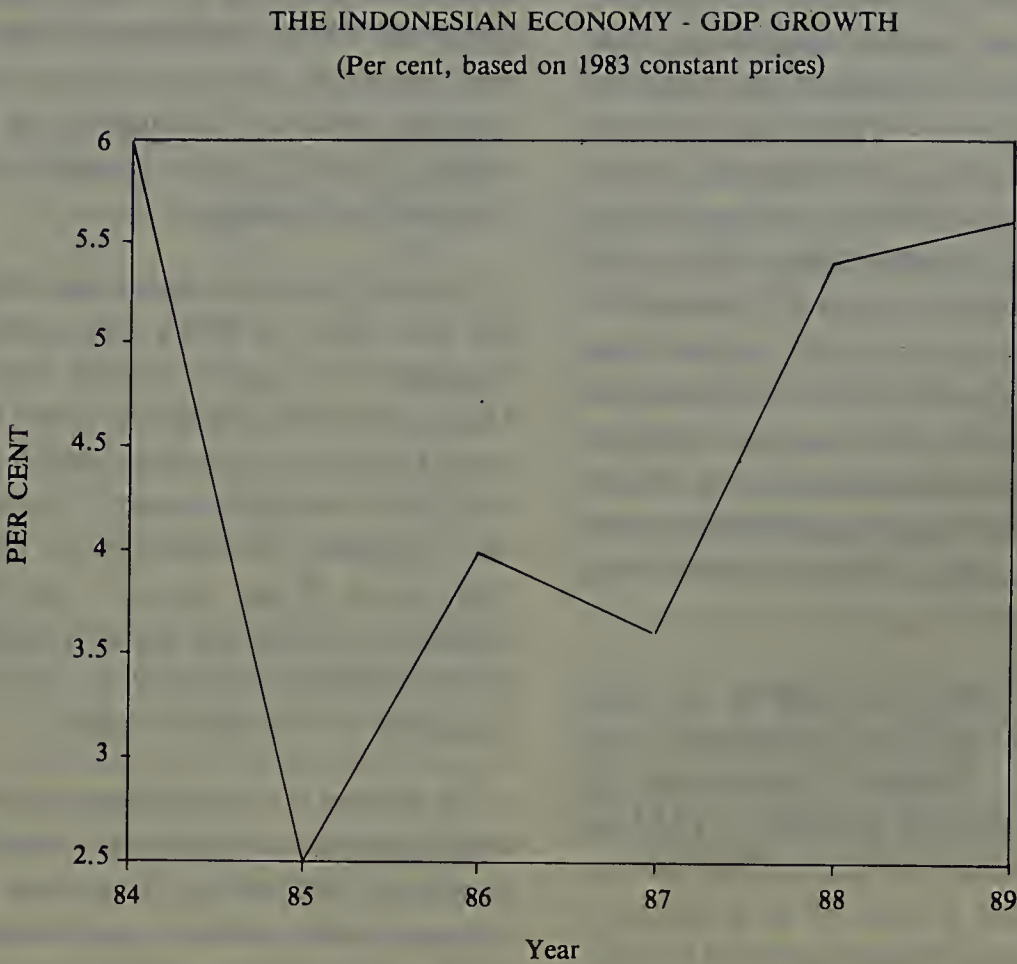
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<sup>1</sup>Center for Policy Studies, *The Indonesian Economy*, Vol. VIII, No. 6 (June 1989).

It is most likely that the main sources of growth in 1988 were the same as those in 1987, which on the demand side was led by foreign demand (exports), followed by a slight recovery of household consumption and a picking up of investments. On the supply side, 1987 saw a significant increase in the growth of manufacturing output which appears to continue until today. Because of time lags in investments, there has been a substantial depletion of the stocks as reflected in the large and negative changes in stock in the national accounts.

Therefore, investment is key to the economy's sustained recovery. Supply constraints may arise if investments continue to lag behind. It should be remembered that this recovery started from a situation of

Graph 1



over-capacity in various sectors of the economy, not only in manufacturing but also in construction.

The 1988 recovery was well managed as shown in the low rate of inflation of about 5.5 per cent. But what about 1989? The target is an inflation rate of less than 5 per cent. However, in the first half of this year, inflation has reached 4 per cent. This should not be a cause of too great concern given the overall economic prospects, which in turn could have a favourable effect on investments.

**The Investment Picture**

The previous year, indeed, saw dramatic increases in planned investments, both domestic (PMDN) and foreign (PMA). Intended investments by domestic companies amounted to over 800 projects, up 37 per cent from the previous year, with a value of close to Rp16 trillion (US\$9 billion), up 37.5 per cent from the previous year. Similarly, investments by joint-ventures amounted to about US\$4.4 billion, up 257 per cent from 1987, for a total of 129 projects (153 per cent higher than in the previous year).



As can be expected, about 60 per cent of total investments by domestic companies, both in value and number of projects, were in manufacturing. The agricultural sector received about 25 to 30 per cent of total domestic investments. Investments by foreign joint ventures (PMA) were even more concentrated in manufacturing: 69 per cent of all investment projects and 78 per cent of the total value of intended investments. About 7 to 8 per cent of PMA investments were allocated to the tourism industry, which in parallel with manufacturing for exports also received a more favourable treatment in the country's efforts to earn more foreign exchange.

Investment approvals during the first quarter of 1989 were as encouraging as in the previous year. Intended investments by domestic firms reached Rp4 trillion. PMA investments amounted to only US\$0.6 billion, but they involve a total of 54 projects or about 42 per cent of those approved in 1987. A number of investment projects in 1988 were unusually large in capital outlays (petrochemicals).

The Asia Pacific region (East Asia) was the main source of PMA investments in 1988, led by the Four NICs (Korea, Taiwan, Hong Kong, Singapore), with 71 investment projects amounting to US\$1.6 billion or 37 per cent of total investments. Investments from Japan amounted to a mere US\$225 million in that year. European investments (West Germany and the Netherlands) are in second place, amounting to US\$1.36 billion for 24 large projects. Investments from the US (2 projects) were also quite significant (US\$534 million).

In the first quarter of 1989, investments from Japan overtake those from other coun-

tries in terms of value, reaching US\$211 million (10 projects) or 34 per cent of total approved PMA investments. The second most important source was Korea with 15 investment projects amounting to US\$157 million. Overall, the investment picture has been quite encouraging.

One of the most important features of this new wave of PMA investments is the dominance of export-oriented investments. This is definitely a response to the introduction of a series of economic policy packages since 1986 which are meant to promote non-oil -- especially, manufacturing -- exports. In 1986 about 38 per cent of total PMA investments were of the export-oriented type. In 1988, close to three-fourth of all PMA investments were export oriented.

A similar trend could also be discerned with regard to investments by domestic companies. In 1988, about 76 per cent of all investment projects were export oriented; two years earlier export-oriented projects constituted about half of the total approved domestic investments.

## **Deregulation and Mobilisation of Domestic Resources**

The encouraging investment picture clearly has resulted from the introduction of economic reform packages as summarised in the Annex. Deregulation of the financial sector, as part of the reform packages, have brought about many favourable effects. One important effect is the more efficient and greatly improved mobilisation of domestic resources.



Table 1

## MOBILISATION OF DOMESTIC RESOURCES

	Nominal Rate of Increase of Savings (%)	Inflation Rate (%)	Real Rate of Increase of Savings (%)
1977-1982 (av.)	19.7	12.2	7.5
1983-1988 (av.)	34.8	7.3	27.5

As can be seen in the Table 1, the period 1983-1988 saw a rise in the rate of increase of savings (in nominal terms) to an average of close to 35 per cent year per annum from an average of less than 20 per cent per annum in the 1977-1982 period. In real terms, the difference is much greater, namely 27.5 per cent per annum average for 1983-1988 compared to 7.5 per cent per annum average for 1977-1982. This suggests that the reform has led to substantial financial deepening. It is only recently that we have observed a favourable development in regard to the other objective of the reform, namely lower interest rates.

## The Government Sector

Sound macroeconomic management has been the key to the current "health" of the economy. In addition to a restraint monetary policy, fiscal policy has played a crucial role. The government's policy of austerity as reflected in the annual budgets for a number of years, has ultimately paid off.

The year 1988 saw the beginning of a recovery in government outlays which was

made possible by improvements in the oil market as well as in the availability and accelerated disbursements of foreign assistance. In fact, realisation of development expenditures in FY 1988/1989 (ending March 1989) has been estimated to be 38 per cent higher than that of development expenditures in FY 1988/1989 (ending March 1989) estimated to be 38 per cent higher than originally planned. Thus, while the debt service burden remains substantial, amounting to 50 per cent of routine (current) expenditures, development expenditures will be allowed to rise in the present budget in line with the good performance of the non-oil sectors in the economy. Revenues from non-oil and gas sectors in the current fiscal year are expected to be about 30 per cent higher than realised in the previous year. Whether or not this target will be met depends upon the country's non-oil export performance.

## Exports

Until the end of the third quarter of 1988 for which the data are available, the country's balance of payments has improved. The current account showed a deficit of less than US\$600 million for the first three quarters. In the previous year, the current account deficit reached US\$18 billion in the first three quarters (US\$2.5 billion for the entire year). This favourable development can be attributed to improved export performance. In particular, this has been due to a sustained growth of non-oil exports, which currently constitute about 60 per cent of total export earnings.

The past years have seen significant changes in the structure of exports, reflecting the ongoing structural reform of the

Table 2

THE GOVERNMENT BUDGET  
(Trillion Rp)

	1988/1989			1989/1990	
	Budget	Est.	Realisation		
<i>Revenues</i>					
A. <i>Dom. Rev.</i>	21.80	23.00	(+ 5.5%)	25.25	(+ 9.8%)
- Oil & Gas	8.86	9.53	(+ 7.6%)	7.90	(-17.1%)
- Non-oil & Gas	12.95	13.48	(+ 4.1%)	17.35	(+ 28.7%)
B. <i>Dev. Ass.</i>	7.16	9.99	(+ 39.5%)	11.33	(+ 13.4%)
- Prog. Ass.	1.66	2.04	(+ 75.5%)	1.80	(-11.8%)
- Proj. Aid	6.00	7.95	(+ 32.6%)	9.53	(+ 19.8%)
Total	28.96	33.00	(+ 13.9%)	36.57	(+ 10.8%)
<i>Expenditures</i>					
A. <i>Routine Exp.</i>	20.07	20.74	(+ 3.4%)	23.44	(+ 13.9%)
of which:					
- Personnel	4.82	5.00	(+ 3.8%)	5.97	(+ 19.4%)
- Debt Payments	10.65	10.94	(+ 2.7%)	12.24	(+ 11.9%)
B. <i>Dev. Exp.</i>	8.90	12.25	(+ 37.7%)	13.13	(+ 7.2%)
- Rp Financing	2.90	4.30	(+ 48.3%)	3.60	(-16.2%)
- Proj. Aid	6.00	7.95	(+ 32.6%)	9.53	(+ 19.8%)

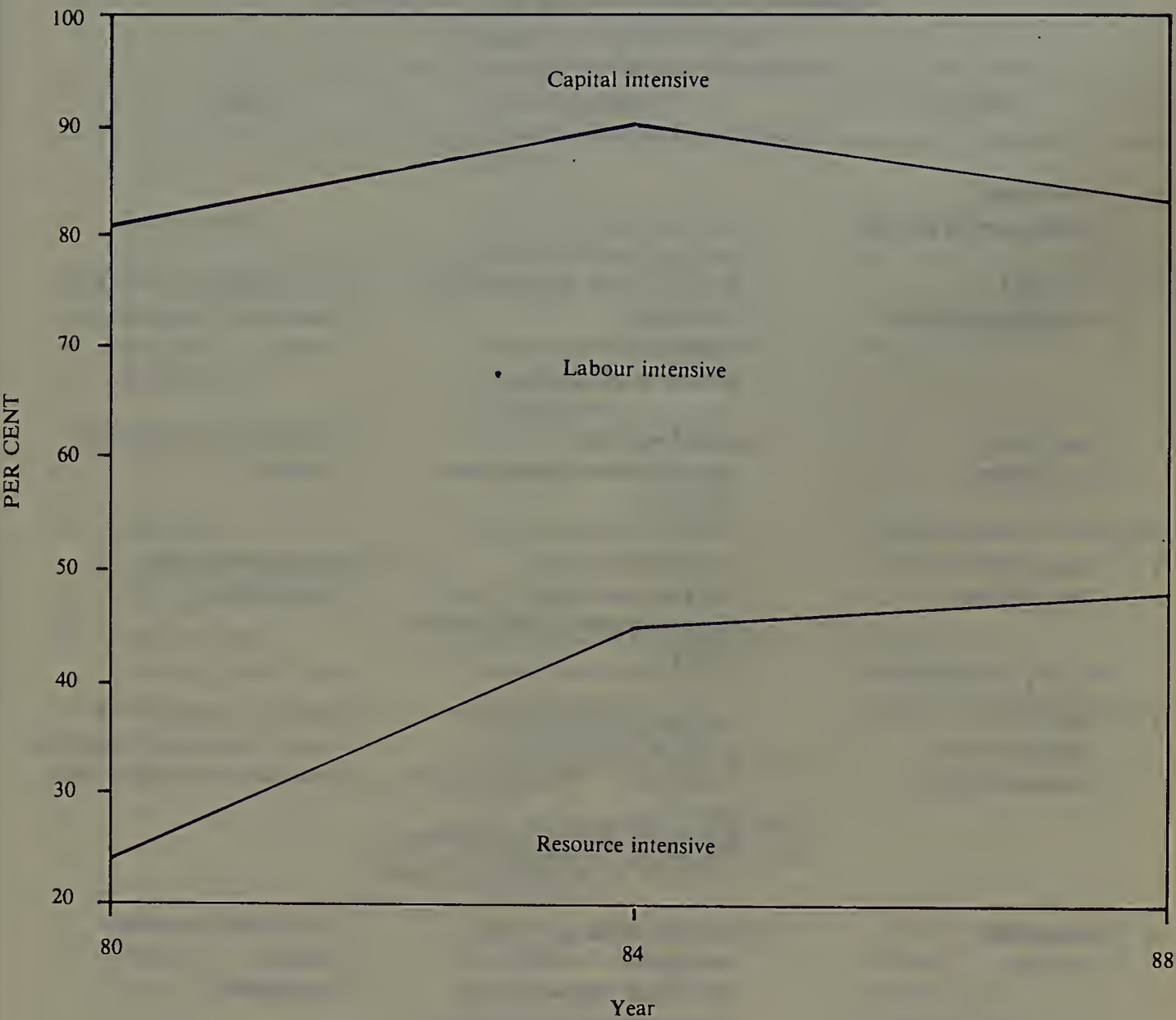
economy as a whole. Whereas in 1980, manufacturing exports constituted a mere 2 per cent of total exports, in 1988 it amounted to 31 per cent of total exports. The composition of manufacturing exports has shifted in the direction of resource-intensive products. This is in line with the country's comparative

advantage. However, it is equally clear that there are still great potentials to further develop and promote the exports of labour-intensive products. Indeed, a large number of recent export-oriented investment projects relate to labour-intensive activities (garment and footwear).



Graph 2

COMPOSITION OF INDONESIAN EXPORTS  
(Per cent)



Concluding Note

Given the favourable effects of the economic reform packages, it is expected that further policies to streamline economic regulations, including deregulation, will continue to be undertaken. Promotion of export activities, through various incentives, is a conti-

nuing effort. This effort has been greatly supported until today by a favourable development in the country's exchange rate.

The reform packages have resulted in the development of a favourable climate for private sector activities. Thus, there is a new optimism in the country that is not too difficult to detect.

## Annex

## SUMMARY OF REFORM MEASURES AND EFFECTS

	Reform	Contents	Effects
1	March 1983 (Devaluation 50 per cent)		
2	June 1983 Banking Deregulation	<ul style="list-style-type: none"> <li>- Remove Interest Rate Control for State Banks</li> <li>- Reduce Liq. Cr.</li> <li>- Remove Credit Ceilings *</li> </ul>	<ul style="list-style-type: none"> <li>- Rise in Deposit Interest Rate</li> <li>- Some Fall in Intermediation Costs</li> </ul>
3	April 1984 Tax Reform	<ul style="list-style-type: none"> <li>- Started with Vat</li> <li>- Rationalisation of Income and Sales Tax</li> </ul>	<ul style="list-style-type: none"> <li>- Some Increase Government Revenues</li> </ul>
4	March 1985 Tariff Reform	<ul style="list-style-type: none"> <li>- Range Reduced from 0-225 per cent to 0-60 per cent</li> <li>- Number of Tariff Levels Reduced 25 to 11</li> </ul>	<ul style="list-style-type: none"> <li>- Reduced Protection</li> <li>- Rationalisation</li> </ul>
5	April 1985 (Inpres. No. 4) Customs Reform	<ul style="list-style-type: none"> <li>- Removal of Customs Dept. in Goods Clearance</li> <li>- Appointment of Private Surveyor SGS</li> <li>- Removal of Restrictions on Choice of Carrier for International Shipment</li> </ul>	<ul style="list-style-type: none"> <li>- Reduced Average Time &amp; Cost of Importing &amp; Exporting</li> <li>- Important Pshycological Effect</li> </ul>
6	6 May 1986 (Pakem)	<ul style="list-style-type: none"> <li>- Duty Drawback and Bypass Monopoly</li> <li>- Armslength Transaction and Computerisation of Processing</li> <li>- Removal of Equity Require Ments on Foreign Ownership for Export Oriented Joint Ventures (up to 95 per cent)</li> <li>- Relaxation on Domestic Distribution for Export Oriented Firms</li> <li>- Joint Ventures can Utilize Export Credit</li> </ul>	<ul style="list-style-type: none"> <li>- Improve Duty Drawback Process</li> <li>- Increase DFI</li> </ul>
7	September 1986	<ul style="list-style-type: none"> <li>- 50 per cent Devaluation</li> </ul>	<ul style="list-style-type: none"> <li>- Increase Non Oil Export</li> <li>- Improve BOP Deficit</li> <li>- Some Confidence Crisis</li> </ul>



	Reform	Contents	Effects
8	October 1986	<ul style="list-style-type: none"> <li>- Removal of Significant no. from Import Licencing to General Importers</li> <li>- Decrease in Tariff for Items Facing Down NTB</li> <li>- Reduction in Tariffs for Goods Needed in Production (Down Effect of Devaluation)</li> <li>- Removal Ceiling on Central Bank (BI) Swap</li> </ul>	<ul style="list-style-type: none"> <li>- Improve Investment Climate</li> <li>- Increase Investments, Especially Export Oriented</li> </ul>
9	January 1987	<ul style="list-style-type: none"> <li>- Removal of Significant from Import Licensing to General Importers</li> </ul>	Ditto
10	June 1987 (Investment)	<ul style="list-style-type: none"> <li>- Deregulation of Investment and Capacity Licensing</li> <li>- Broad Banding</li> <li>- Closed Sector Open for Export Oriented Firms</li> </ul>	Ditto
11	July 1987 (Simplification of Textile Quota Allocation)	<ul style="list-style-type: none"> <li>- Transparency of Allocation</li> </ul>	<ul style="list-style-type: none"> <li>- Improved Exports of Textiles and Garments</li> </ul>
12	December 1987 (Pakdes) Capital Markets	<ul style="list-style-type: none"> <li>- Deregulation of Capital Markets</li> <li>- Reduce Government Role in Stock Exchange</li> <li>- Foreigners can Buy Stocks</li> <li>- Tourism and Hotel Sector Deregulation</li> <li>- Exporter Reclassified to Exporting 65 per cent (CF 85 per cent Before) of Production</li> </ul>	<ul style="list-style-type: none"> <li>- Ditto</li> <li>- No Significant Effect on Capital Market Activity Yet</li> </ul>
13	27 October 1988 (Pakto) Financial Deregulation	<ul style="list-style-type: none"> <li>- Open Up Licenses for New Banks and Foreign Joint Venture</li> <li>- Lending Limits Regulations (Safety and Soundness)</li> </ul>	<ul style="list-style-type: none"> <li>- 3 New J.V. (Japanese and French)</li> <li>- 17 New Banks</li> <li>- Increased Comp.</li> <li>- Rising Interest Rates &amp; Falling Spreads</li> </ul>
14	20 November 1988 (Paknov) Trade (Plastics)	<ul style="list-style-type: none"> <li>- Removal of Import Monopolies: Plastics &amp; Steel</li> <li>- Shipping Deregulations</li> <li>- Foreign Investors Allowed to Distribute Prods. Dom.</li> </ul>	<ul style="list-style-type: none"> <li>- Positive Sign of Seriousness of Govt. Apparent</li> <li>- Some Inconsistencies</li> <li>- Improve Investment Climate</li> </ul>
15	24 December 1988	<ul style="list-style-type: none"> <li>- Further Capital Markets Deregulations</li> <li>- Deregulation in Insurance Industry</li> <li>- Rationalisation of Financial Services</li> </ul>	<ul style="list-style-type: none"> <li>- Sharp Increase in Capital Markets Activity, Albeit Absolute Level still Low &amp; Market still Shallow</li> </ul>

# Sino-Soviet Summit

*J. Soedjati DJIWANDONO*

**T**HERE IS NO DOUBT that the meeting between Mr. Gorbachev and Mr. Deng Xiao-ping in Beijing in May this year served as the crowning occasion for the process of Sino-Soviet detente that had been going on for a few years. Just as the detente between the Soviet Union and the United States, Sino-Soviet detente will also help reduce international and regional tension. It will help create a new more favourable climate for trade and economic relations not only between the two giant socialist countries but also between themselves on the one hand and other nations in the region of the Asia-Pacific including Southeast Asia on the other. This in turn will help the pursuit of their respective national developments. It is clear that both the PRC and the Soviet Union have strong motivation for normalisation of their relations. And apart from strategic considerations, they both have a great interest in the creation of a stable and peaceful international environment. They need this for the success of their domestic reforms and modernisation, for which they can ill afford to maintain a relationship with each other, or with any other big power, in an atmosphere of frequent tensions and imminent confrontations. Nor can they continue to be engaged in regional conflicts by providing economic and military assistance for their respective protagonists without

eventually damaging their own already stagnant or deteriorating economies.

The new more favourable international climate will also be enhanced by the improved image of the PRC and the Soviet Union towards moderate and peaceful representation. In this sense the Sino-Soviet summit has been a confidence-building measure of great importance, for it will help allay mutual suspicion and promote mutual understanding and trust.

As far as the region of Southeast Asia is concerned, it may be true that in the light of Sino-Soviet differences the two big powers may not be likely to return to their alliance association of the 1950s. They may indeed continue to be engaged in a competitive relationship. This would imply that Southeast Asia is likely to continue to be an arena of rivalry not only between the two superpowers, the Soviet Union and the USA, but also between the former and the PRC. Nevertheless the new detente would render their competition less marked by violence, less militaristic, and thereby reducing the danger of the region of Southeast Asia being embroiled in a Sino-Soviet conflict or Soviet-US conflict.

Whether or not because of their continued adversarial or competitive relationship



Southeast Asia would be exposed to the threat of external major power interference would largely depend on the ability of the Southeast Asian countries themselves to put their own houses in order, to maintain domestic and regional stability, to develop their national and regional resilience. Peace and stability in the region would be the primary responsibility of the regional states themselves.

There is, indeed, some degree of uncertainty, despite the improved image of both the Soviet Union and the PRC towards moderate and more peaceful representation as referred to earlier, as to their possible future international behaviour, given the success of their domestic reforms and modernisation. That is to say, there is certainly no assurance that they will continue to pursue their moderate and peaceful policies and not return to a militant and revolutionary posture in their foreign relations. The recent events in Beijing, in which reportedly thousands of non-violent, pro-democracy student demonstrators were brutally crushed, may have served to reinforce that uncertainty.

However, seemingly being unable to do much about them nor to bring pressure to bear on the Chinese so as to change their policy on what they claim, perhaps rightly, to be their strictly domestic affairs, the outside world may have no other alternative but to continue to give the Chinese, and the Soviet for the matter, the benefit of the doubt. And while it is not easy to ascertain the long-term intentions of these giant communist states, one can perhaps bet on the possibility that the success of their domestic, especially economic, reforms or modernisation would mean that they would have a greater stake in the present international order and in international peace and stability.

In this sense they would become more responsible members of the international community and have great interest in maintaining peaceful and friendly relations and co-operation with the outside world. And in the increasingly interdependent world of today, they would certainly have more to lose in an international climate marked with tensions, conflicts and confrontations.

Thus with the evolving detente, the great powers may be even more aware of their common interest in the stability of not only Southeast Asia but the Asia-Pacific region at large. This may help discourage them from interfering in the domestic and regional affairs of the region for their own benefit. To this end they have a common interest in maintaining a balanced relations among themselves as well as with the countries of the region.

It is in the light of these possibilities that the process of normalisation between Indonesia and the PRC, given momentum by the meeting between the Chinese Foreign Minister and the Indonesian President in Tokyo in June this year, if somewhat belatedly, may be appreciated.

Finally, it may be hoped that both the PRC and the Soviet Union will play their respective regional roles in a more positive and constructive way in the context of their detente particularly in helping the efforts to find a peaceful solution of regional conflicts. This is particularly true with the Kampuchean conflict, a major preoccupation of the Southeast Asian countries for over a decade. It does not mean that they alone must make decisions for the region, but they should play their proper roles in co-operation with the regional powers as well. But even in the case of the Kampuchean conflict, in the last analysis it is largely up to the Kampuchean

people themselves how they would shape their own future.

Apart from the Kampuchean conflict, however, there are seeds of potential conflicts in the future, such as those that may arise in the south China Sea. But with con-

tinued evolution of great power detente and efforts at confidence building, and continued improvement in the relations among nations in the region and external powers, one would hope that peaceful settlement of disputes may be expected to develop into a durable pattern.



# Structural Adjustment in Indonesia: Export and the “High-Cost” Economy

*Ali WARDHANA*

**I**NDONESIA has been undergoing a process of economic reform -- another term for structural adjustment -- for at least five years. During that time it has gained considerable experience and learned a great deal about the process of reform. There is much in the Indonesian situation that is not easily transferred to other countries. But some of the lessons that it has learned may be useful to others who set out on this sometimes difficult path to economic reform. In my exposé in describing the Indonesian experience I would like to leave to the readers the task of drawing any lessons that may be relevant for other countries or that may contribute to our general understanding as to how structural adjustment works in developing countries.

---

Keynote Address at the Twentyfourth Conference of Southeast Asian Central Bank Governors (Seacen Governors), Bangkok, 25 January 1989.

## **The Rationale for Structural Adjustment in Indonesia**

Economic reform is rarely if ever undertaken for its own sake. Pressures for reform generally emerge from some crises: external price shocks, abrupt changes in domestic economic conditions, or shifting political circumstances and pressures. In Indonesia, the crisis was the slump in world prices of oil that began in 1985. Given that shock, a simple chain of economic reasoning makes it clear why economic policy makers were drawn inexorably down the path of structural adjustment:

- Economic growth and development is a central goal of government policy.
- Economic growth requires export growth to pay for needed imports and to service debts.
- Given the level and uncertainty of oil prices, and Indonesia's level of proven oil

reserves, the only reliable source of export growth for Indonesia is a wide range of non-oil exports both from agriculture and from manufacturing.

- Non-oil export growth requires an efficient, low-cost, productive economy to enable firms to compete in world markets. This in turn requires a competitive domestic market.
- Protection and government controls, which had been the chosen policy instruments for many years, are inimical to this competitive domestic market; they have created the "high-cost" economy that the country is now trying to escape.
- To encourage exports and economic growth, therefore, Indonesia needs to dismantle its protective policies and government controls, and to "deregulate" its economy.
- A corollary is that non-oil government revenues must also be developed if the government is to play a constructive role in development.
- The benefits of deregulation and economic growth must be widely and evenly spread among the population. In particular, development of the rural areas should continue to be emphasized in any set of economic reforms.

All the economic reforms that have been undertaken in Indonesia have been guided by this chain of reasoning, from growth and development through non-oil exports to deregulation and greater reliance on more competitive markets.

### **Economic Stabilization: A Precondition for Reform**

Before delving into a description of structural adjustment as practiced in Indonesia,

however, a precondition for economic reform, namely economic stabilization, will be discussed further. Stabilization and structural adjustment go together, like the IMF and the World Bank. Indeed, the IMF is associated with stabilization and the Bank with structural adjustment. Around the developing world, IMF stabilization programmes have taken precedence over World Bank structural adjustment programmes, and with good reason. Economic reform is unlikely to take root in an unstable, inflationary economic environment.

There are three reasons for this. *First*, inflation distorts the price incentives that are at the core of structural adjustment. In an inflationary economy, large profits are to be earned by beating inflation. Many of the most talented entrepreneurs and businessmen thus spent most of their energies on investments and other activities that take advantage of inflation, and they necessarily ignore other, less rewarding activities that increase efficiency and boost productivity. Because productivity growth is essential to economic development, inflation drains resources away from development. There is no point in starting market-based reforms when inflation nullifies their impact.

*Second*, the crises that abound in an unstable economy draw the attention of policy makers and economic managers away from the arduous tasks of steering reforms through the political and economic system. There is only so much managerial capacity in any country. Anyone who has been through a balance-of-payments crisis or an unsustainable budget deficit knows how little capacity is left to cope with tariff reforms or the development of financial markets.

*Third*, many of the features of a stabili-



zation programme are also essential for structural adjustment. Alignment of an overvalued exchange rate, adjustment of interest rates to yield positive real returns, the balancing of budgets to shift more resources into private hands -- these and other components of stabilization are the beginning of the structural adjustment process itself.

In Indonesia people have long recognized that sound macro-economic management comes before all other economic policies. Even during the oil boom of the 1970s, Indonesia maintained a balanced budget, and continue to do so even in the more difficult circumstances faced today. Furthermore, the infamous Pertamina affair of the mid-1970s turned out to be a blessing in disguise, because it educated the Indonesian people on the importance of prudent borrowing policies and the dangers of overborrowing years before the full force of the debt crisis descended on the world. Since that time, prudence has been Indonesia's policy. Thus, unlike other oil exporting countries, the country's service ratio remained moderate throughout the oil boom period -- in 1981, the ratio of public debt service to exports was only 9 per cent, and even by 1985, it was only 18 per cent.

However, even while Indonesia enjoyed ample oil revenues, it looked ahead to the days when it might not be so fortunate. Export diversification became a policy as early as 1978, when Indonesia devalued the Rupiah by 34 per cent against the Dollar to stimulate non-oil exports and to ward off the impact of the so-called "Dutch disease" on the non-oil economy. Principal among our concerns then was to protect the incomes of farmers by giving them a greater incentive to grow rice for the domestic market and to produce many commodities for export. In 1983, almost three years before the collapse

of oil prices, Indonesia instituted a tax reform to enhance the yield of non-oil revenues. The income tax was overhauled and a value added tax introduced. The value added tax now accounts for more than one-fifth of its total domestic revenues.

During the past three years of falling oil prices, Indonesia's efforts to stabilize the economy have become more intense. The budget caution of the earlier period has become budget austerity. It is testimony to the magnitude of the crisis that the share of oil and gas receipts in the government's domestic revenues (that is, excluding foreign aid) has fallen from 65 per cent in 1984 to around 40 per cent in the current fiscal year. Civil service salaries were frozen for four years and development expenditures were cut to the bone, from 10.7 per cent of gross domestic product in 1985/1986 to 5.9 per cent in 1988/1989. Total government expenditure as a share of gross domestic product shrank by 1-2 percentage points during this period, while net government spending, after deducting debt services, fell by 6 percentage points of gross domestic product.

By controlling the budget, Indonesia was in a strong position to deal with monetary pressures when they arose. Growth in Rupiah liquidity has remained under control, and in response to speculative outflows of capital, measures were taken to curtail domestic credits and raise domestic interest rates. As one consequence of this cautious monetary policy, inflationary pressures have been kept under control, despite the 31 per cent depreciation against the Dollar in September 1986. (In measuring devaluation, I am following the IMF practice of using the Dollar price of Rupiahs.) In 1986 and 1987, inflation was restrained to around 9 per cent annually, with 1988 inflation estimated at 6-7 per cent.



The last several years have also witnessed severe realignment among international currencies, most notably the depreciation of the Dollar against other major currencies. Coming at the same time as the weakness in oil prices, Indonesia has been caught in a scissors effect. With 40 per cent of its external debt in Yen and 20 per cent in other non-Dollar currencies, the Dollar value of the debt has risen sharply, while the fall in oil prices has reduced the resources available to service this debt. It is estimated that the weakened Dollar alone has added around US\$1.6 billion, or nearly 40 per cent, to Indonesia's annual debt service obligations since 1985. Meanwhile, lower oil prices cut its export earnings by nearly US\$6 billion in 1986, with little recovery since.

As a result, Indonesia has been forced to borrow more, and has struggled to keep debt service within its capacity to repay. Debt service payments have risen to more than 50 per cent of the government's routine budget, and have been a major cause of the country's budget austerity. Fortunately, its ongoing programme of structural reform, together with the generous support of bilateral and multilateral lenders, has allowed Indonesia to obtain sufficient resources while avoiding crisis. Indeed, despite the reverses since 1985, international reserves remain equivalent to about 6 month's worth of imports.

This, then, has been Indonesia's survival strategy: stabilize the economy, rather like an army under attack that struggles to hold its line intact, while waiting for the moment to counter-attack. People have been preparing for the counter-attack by undertaking a substantial structural adjustment, putting in place the elements for renewed growth even while they struggled to stabilize the economy.

## **The Components of Structural Adjustment**

Structural adjustment is a broad concept covering many aspects of economic management. To give some focus to the Indonesian experience, allow me to simplify a bit and suggest that there are three basic components to structural adjustment as the term is generally used in Indonesia. These are getting prices right, letting markets work, and reforming public institutions.

"Getting prices right" has been a catchphrase for economic reform for at least a decade. Economists mean by this the adjustment of key prices to reflect the real values of scarce commodities and resources. Producers and consumers, if they are to allocate resources most productively, need to base their transactions on the true scarcity values of foreign exchange, capital, labour, land and other resources. Most economists assume that the market is the best arbiter of "right" prices. But this is not necessarily the case. Indeed, most governments carefully manage some of the most important prices: the exchange rate, interest rates, and basic food prices are often controlled or influenced by government rather than left to be determined solely by market forces. Still, these and other controlled prices can be gotten "right" through sound management.

That leads to the second component of structural adjustment: letting markets work. One advantage of letting markets determine prices is that it frees the energies of economic managers to concentrate on other essential reforms. But a more important advantage is that freer markets induce more competition. Competition, in turn, forces all producers to watch their costs and, in the process, to in-



crease their productivity. We observe that open economies that face foreign competition, and those that give free reign to competition from within, often enjoy large productivity gains and hence more rapid economic growth. This lesson, once confined to the mixed economies of the west and the developing world, has now been learned by the socialist countries as well. In a competitive environment, the profit motive -- which may be one of the strongest of all human drives -- becomes the very instrument by which productivity can grow, incomes can be raised, and welfare can be increased.

However, it is not possible to give freer reign to the market with a stroke of the pen. Permitting more decisions to be made by the market requires that fewer decisions be made by government bureaucracies. Not only must there be less bureaucracy, but bureaucrats must take on a new role. Instead of intervening to control private economic agents, bureaucrats need to avoid intervention and instead to facilitate private activity. This change of both function and attitude constitutes the third component of structural adjustment, reforming government institutions. Economists often overlook this component and managers often shun the task, because it can take years to transform bureaucracies. But unless institutional reforms are made, the old bureaucracies, acting in the old ways, can stifle the competitive effects of other measures and thwart off the intentions of economic reformers.

I would now like to turn to the structural reforms carried out in Indonesia and discuss them as illustrations of the three components: getting prices right, letting markets work, and reforming government institutions.

## Getting Prices Right

There is no need to remind the readers that the exchange rate is probably the single most important price in any open economy. Until the exchange rate is moved close to its equilibrium level, other reforms could easily make things worse rather than better. In Indonesia people have actively used the exchange rate as a tool to promote non-oil exports since 1978. In that year it was devalued by 34 per cent against the US Dollar (measured in Dollars per Rupiah) and devalued again in 1983, by 28 per cent. In both cases, domestic inflation eventually eroded the Rupiah value of the Dollar, so in 1986 it was devalued again by 31 per cent. Since 1986 Indonesia has managed the rate to maintain and even to extend the real value of the currency depreciation established in 1986. This sustained incentive to exporters has given the country a solid platform from which to launch other reforms designed to promote non-oil exports.

The exchange rate is important to all Indonesians. In the rural areas, it provides stimulus and incomes to the producers of export crops. However, the domestic price of rice may be even more crucial to the welfare of farmers as well as low-income consumers. Since 1968, the government has purchased and stored rice in order to set a floor below which the price cannot fall. Our approach in recent years has been to set the minimum producer price so that it approximates the long-term trend of the world price for imports of rice to Indonesia. However, the domestic price of rice is not allowed to follow the world price as it fluctuates about its long-term trend. Instead, Indonesia tries to smooth out the fluctuations to stabilize the incomes of rice farmers and the purchasing



power of consumers.

World price trends have enabled Indonesia to increase the real price of rice over the years, providing rising incomes to farmers. Together with a subsidy to fertilizer, investment in irrigation, and the rapid spread of new seed varieties after 1977, this price policy has also enabled the country to maintain self-sufficiency in rice and stimulate development in the rural areas.

## Letting Markets Work

Much of Indonesia's effort in structural adjustment has centred on what is known as "deregulation." This is the component of reform that I have called "letting markets work." Indonesia has made important gains in two areas: deregulation of trade and deregulation of financial markets.

It is said that good things come in small packages. In Indonesia, economic reform comes in what is called "deregulation packages." Five trade deregulation packages were announced in May 1986, October 1986, January 1987, December 1987 and November 1988. Prior to October 1986 there were about 1,200 imported items under some form of non-tariff barrier, usually a licensing restriction that allowed only one or a small number of firms to import a particular item. These restrictions covered about 35 per cent of total imports by value, providing them with high protection. But the restrictions also injured firms, particularly exporters, who enjoyed little protection and had to purchase those protected imports. Trade deregulation has introduced competition to the manufacturing sector, mainly by opening the economy further to low-cost imports.

The first package, announced in May 1986, made a direct assault on the high-cost economy as it affected exports. That package replaced an export subsidy programme -- one that did not conform to GATT rules -- with a duty drawback and exemption programme to allow exporters to escape import duties and sales taxes. Equally important, the package allowed exporters to procure imported inputs directly themselves, without the requirement of going through licensed importers who often raised the cost of importing.

Subsequent reform packages cut away at the non-tariff import restrictions. Some items were moved from more to less restrictive import categories; others were shifted to the category of "general importer" with no restrictions. Tariffs were adjusted in both directions, either downward, to reduce costs and protection where possible, or upward, if necessary to ease the transition for protected firms which are losing non-tariff barriers. Each of the packages concentrated its changes on two or three industries in an attempt to have a discernible impact on costs and efficiency. Textiles, agricultural processing, plastics, chemicals, steel, machinery and equipment have each been partially or substantially deregulated. Over two and a half years, almost half of the 1,200 non-tariff barriers have been dismantled and virtually every sector of the economy has been affected.

Trade deregulation is an unfinished story. There remain important pockets of protection, import restrictions that raise costs and penalize both exporters and consumers, and a number of restrictions on exporters themselves. The government is committed to relaxing such constraints over time and more packages are being readied for



delivery. So far Indonesia has concentrated on introducing competition to the manufacturing sector by lowering non-tariff barriers. The future agenda will have to include more action on tariffs, both to get prices "right" by reducing distortions and to lower further the barriers to competition from imports. The assault on the high-cost economy will continue, because it is the core of our strategy to promote productivity growth and economic development.

The five deregulation packages did more than ease trade restrictions. The most recent package completely deregulated inter-island shipping, simplifying and relaxing licensing requirements and thus opening the industry to greater competition. This reform is another major attack on the high-cost economy. Other packages have encouraged foreign investment in a number of ways, including the relaxation of requirements for local ownership, especially for projects involving high risks, sophisticated technology, large capital requirements, or exports equal to at least 85 per cent of production.

The second area in which we have made great strides is the deregulation of financial markets. Reform packages were announced in June 1983 and in October and December 1988. The first of these abolished all credit ceilings, permitted banks to set their own interest rates on most loans and deposits, and reduced the use of subsidized credits from Bank Indonesia. The recent reforms were designed to enhance competition within the financial sector by removing some of the barriers to entry that remained in place following 1983. They eased restrictions on the operations of foreign banks, made it simpler to establish branch banks, and reduced the requirements for becoming a foreign exchange bank. Moreover, they re-

duced the special privileges and responsibilities of government-owned financial institutions, and narrowed the differential tax treatment of the various financial instruments.

The October 1988 package improved Indonesia's ability to promote the development of money markets by lowering the reserve requirement for banks and other financial institutions from 15 to 2 per cent; by introducing an auction for the sale of central bank bills; by extending the period for foreign exchange swaps from 6 months to 3 years; and by setting the swap premium as the difference between the domestic and offshore deposit rates. Monetary control has shifted from reliance on direct intervention to indirect management, through the use of increasingly sophisticated monetary instruments, prices at marked-determined rates.

The December 1988 package is directed mainly at encouraging longer-term sources of finance. One set of measures permits the opening of private securities markets while also clarifying regulations governing insider trading and other unsound practices. A second set of measures encourages the development of new financial services such as venture capital, leasing, factoring and credit cards. A third set clarifies the regulations covering insurance companies. Indonesia is still working on legislation concerning pensions, mutual funds or investment trusts, and consumer and investor protection.

These financial and money market reforms should intensify competition in financial markets, encourage new channels for financial intermediation, and reduce the cost of intermediation. Financial market reforms will support trade reforms by increasing savings and channeling them towards the newly



profitable export industries and other productive sectors.

## Reforming Government Institutions

The efforts to get prices right and let markets work will come to nothing if government institutions continue to interfere in the operation of markets. Indonesia has implemented several strategic reforms of government agencies in support of its market-based reforms.

The most dramatic of these was Presidential Instruction Number 4 of 1985. These decrees took the unprecedented step of virtually abolishing the Indonesian customs service and replacing its activities with the services of SGS, an international surveying company. With the stroke of a pen, importers were freed from the corruption of customs agents, the long delays in clearing goods, and the high-costs involved in moving goods from ships into factories. Within months, delays in clearing import shipments had been reduced from weeks to days. Coming early in the structural adjustment process, this was a clear signal that government was determined to squeeze high-costs out of the economy.

This reform is not finished, however. Having moved the customs service to the sidelines, Indonesia now must bring it back into play. Customs is being overhauled to make it capable of providing honest, efficient and effective service to both importers and the government. Eventually, Indonesia will have a national customs service that is an effective instrument for carrying out tariff and other trade policies.

Deregulation of financial markets has also been supported by institutional reforms.

Earlier, I mentioned the development of money markets through the auction of central bank bills. To make these auctions effective, and to allow Bank Indonesia to realize its full potential for management of the money supply, it is essential that a secondary market in central bank bills be developed. The October 1988 package provided for such a market, but bankers have been hesitant to use it. Indonesia now face the task of creating the institutions and procedures for efficient secondary markets for high quality, short-term paper. Then financial institutions and other firms must be encouraged to incorporate such instruments into their decisionmaking about portfolio management. In short, Indonesia need to create new money markets that will serve as the centrepiece for the whole financial system and will help to guide all financial prices towards their equilibrium values.

Earlier, I emphasized the importance of stimulating rural development and protecting rural incomes. Because of this concern, Indonesia has also extended financial reform to the rural areas. Through the Bank Rakyat Indonesia or BRI it has replaced targeted, subsidized loan programmes with a rural savings scheme and a loan scheme, both based on market interest rates. These reforms required the village units of BRI to stop acting as subordinate bureaucratic units and to start behaving as profit-maximizing businesses.

One approach to the BRI reform was market-based: village units were offered cash and other incentives to behave as bankers. But local unit personnel also required instructions and training to change their behaviour. Responsibility for loan decisions had to be delegated from branch offices to the village units, while regional units



had to de-emphasize their control-minded approach to become more promotional. In a large, complex institution like BRI, these changes took careful planning and implementation. This was a major institutional reform and it has been successful. As a consequence, rural savers now have a rewarding outlet for their funds, while farmers and others with productive uses for credit have access to loans on commercial terms.

## Questions of Timing

We hear a great deal from experts about the benefits of structural adjustment and the precise reforms that should be undertaken to realize these benefits. We hear a great deal less from experts about the *sequence* in which reforms should be undertaken. Should trade reforms come before or after capital market reforms; and at what point should restrictions on foreign capital be relaxed? Getting the sequence wrong can doom the reform programme we are told.

We also receive contradictory advice about the timing of reforms. Some suggest that the political opportunity for reforms is fleeting, and there is much to be done, so that *shock treatment* is prescribed: get as much as possible accomplished in the shortest possible time. Against this is the often limited capacity of the government to plan and implement reforms, suggesting *gradualism* as an alternative strategy, perhaps the only feasible strategy. These are crucial questions. Although I cannot answer them definitively, I can offer some insights from the Indonesian case.

To begin with *sequencing*, Indonesia began its structural adjustment period with an economy that was not badly distorted.

Foreign exchange transactions have been unrestricted for two decades and people dealt with overvaluation of the exchange rate periodically, as required. Labour markets have been relatively unfettered by restrictive labour agreements or by controls over wages. Indonesia has made progress in reducing the distortions of trade policy over the past few years. One effect has been to make manufacturing exports industries more profitable than before, a clear signal to invest in these lines of production. However, there remain distortions in favour of inefficient import-replacing industries, so the process of changing market signals is not complete. Indonesia may therefore expect some investment to flow into less efficient industries.

Nevertheless, Indonesia has proceeded to deregulate and develop domestic financial markets and has made it easier for foreign investors to enter the Indonesian market. This suggests some continuing need to monitor the industries in which investment takes place. Investment restrictions are not part of the structurally adjusted economy. However, as an interim measure they may be useful to prevent investment in sectors that have not been fully exposed to reform. The faster Indonesia is able to dismantle the remaining distortions due to trade policy, the sooner it can move towards even less regulation of investment.

Some countries, especially in Latin America, have run into trouble when they freed both domestic financial markets and the flow of foreign capital. One prescription from experts on Latin America, therefore, is not to relax controls on foreign capital flows until the domestic financial market has been deregulated and interest rates have settled to some long-term equilibrium. In Indonesia,



however, people did the opposite. With foreign exchange freely convertible for 15 years, they freed up domestic interest rates in 1983 and further deregulated the financial markets just three months ago. As in Latin America, domestic interest rates have been high ever since, with deposit rates some 7 to 9 points above the rate of inflation and lending rates another 5 points higher. Yet they have not had the destabilizing flows of foreign capital experienced in Latin America. Given cautious fiscal, monetary and foreign exchange management, the financial markets seem to be in equilibrium with these rates. Of course, one task for the future, and an objective of financial reform, is to bring these high rates down as the financial system becomes more competitive, more efficient, and better integrated.

On the issue of *timing*, Southeast Asia, indeed Asia in general, seems to stand apart from the experience of many countries of Latin America and Africa. There, "windows of opportunity" for fundamental restructuring seem to occur mainly when governments change, especially when the outgoing government's economic policies have been discredited by events and by public opinion. In Indonesia, as in many countries of Asia, people have had reforms with a stable government -- in this case for more than two decades.

Instead, the spur to reform has been the price volatility that has faced oil exporters to this day. The government has been associated with sound macro-economic management for many years. So when Indonesia faced declining oil prices, public opinion could be easily mobilized in support of necessary measures, including reforms. There is a difference between now and a decade ago. Then, as now, the country could gain sup-

port for macro-economic measures to stabilize the economy. Today, more so than a decade ago, it is evident to everyone that sound micro-economic management as well is needed, because export growth requires a low-cost economy. The chain of reasoning with which I began this exposé is widely understood and increasingly accepted in Indonesia, at least in its broad outline.

With the extended oil crisis, gradualism has been a possibility for Indonesia. This is fortunate, because it has enabled policy makers and implementors to work within their capacities to plan and execute reforms. Moreover, gradualism has the advantage of progressively winning over a new constituency for further reform. As businessmen, especially exporters, begin to recognize the benefits of a low-cost economy, new voices appear in support of further structural adjustment.

## Outcomes of Reform

Turning from the *process* of reform to the *outcomes* of reform, several features are worth mentioning. First of all, the shift of incentives towards non-oil exports has been a dramatic success so far. In the years after 1985, when the reform process began, the Dollar value of non-oil exports grew by 11 per cent in 1986, then by 31 per cent in 1987; in 1988, it was estimated that non-oil exports grew substantially faster than in 1987. Manufactured exports have virtually exploded, growing at 51 per cent a year since 1985. Such rapid and accelerating growth during a period of declining oil revenues implies a drastic transformation in the sources of export earnings: in 1984, non-oil and non-gas revenues accounted for 27 per cent of total



export earnings; by 1987, this share had risen to 50 per cent. And by mid-1988, manufactured export earnings had grown to half of all non-oil export receipts. Projections for the coming five year period, based on a forecast of 15 per cent growth in non-oil exports, point to a further decline in the role of oil and gas exports.

The financial reforms of 1983 have also had a substantial impact. Perhaps the best measure of Indonesia's success in encouraging intermediation by the banking system is the ratio of bank assets to gross domestic product. In 1983, the year of the first deregulation, bank assets were equivalent to 26 per cent of gross domestic product. Last September they represented 46 per cent of gross domestic product. Although all banks contributed to this remarkable growth, private banks did especially well. Their assets increased by 38 per cent a year over the period since 1983, and now account for 39 per cent of total bank assets. Indonesia expects that the reforms of 1988 will give further impetus to the development of the financial system. In particular, the country look forward to a decline in interest rates and especially in the spread between borrowing and lending rates over the next few years.

The BRI rural credit reforms have also enjoyed remarkable success. From early 1984, the first year of the reforms, until early 1988, the volume of rural credit outstanding from the BRI village units expanded by a factor of 12 in constant prices, while savings deposited in these units rose by a factor of 9.

Outstanding credit had reached US\$270 million, with arrears below 7 per cent. The village units reduced the costs of intermediation from almost 60 per cent of outstanding credit in 1984 to less than 14 per cent in early 1988, and were earning profits of more than 20 per cent of loans outstanding. Here, then, is a clear example of market-based economic principles working in concrete ways to improve productivity and welfare in the rural areas.

Earlier, I touched on Indonesia's efforts to stabilize the economy, including budget austerity, monetary prudence, exchange rate flexibility, and the willingness of foreign governments and investors to transfer capital to Indonesia. The country's combination of macro-economic stabilization and structural adjustment has alleviated the impact of external events on economic growth. Unlike the experience in many other areas of the world, growth has remained positive throughout the last few years, from a low of 2.5 per cent in 1985 to around 3.5-4.0 per cent in each of the three years since then. Some Indonesian economists have projected growth as high as 5 per cent for the fiscal year 1988/1989. No doubt much lower than the growth rates experienced by Thailand, Singapore or Malaysia. Indonesia therefore places great emphasis on the need to achieve higher growth in the coming period, in order to provide productive jobs for the growing labour force and to return to the growth trajectory of the 1970s that had led to widespread improvements in living standards for the majority of Indonesians.

# Economic Policy Reforms in Indonesia

*Mari PANGESTU*

## Introduction

**T**HE EXPERIENCE of Indonesia with trade reforms and industrial restructuring have varied over the "New Order government" period. An historical overview suggests that major changes in the direction of trade and industrial policy are linked to major political and economic crises. While the need to undertake reforms may already exist amongst groups both within and outside the government for some time, usually the necessary political will to undertake the measures comes from major political and economic crises. Furthermore, the most important economic change currently providing the impetus for reform is an externally generated one -- the fall in the price of oil.

The aim of this paper is to analyse the process of economic policy reforms in Indonesia, especially in the present deregulation phase (the post oil boom period of 1982-present).

In this context, trade reforms are interpreted as policies that affect exports and imports directly, while industrial reforms affect the industrial structure of the economy through investment decisions or directions of market orientation, that is, import substitution or export orientation. Changes in macro economic policy, especially exchange rate management are included also because they are part of the general restructuring strategy.

Even though substantive trade and industry reforms were undertaken in the early years of the "New Order" government, the focus will be on the more recent period of reforms. In the early period of 1967-1972 the impetus for reforms was the change in government. In the recent period of deregulations, reform was motivated by the rapid decline in the price of oil which implied the need to increase the role of private sector investment and expand non oil exports.

The remainder of this paper is divided into two main sections. The first section serves as background leading up to the analysis of



policy reforms currently being undertaken. In the second part of the paper an analysis of the process of policy reforms undertaken in the present deregulation phase, the oil price decline period of 1982-present, is analysed in greater depth.

### **Background: Changes in Policy Direction in Indonesia in the New Order Period 1967-1981**

Identifiable periods of protectionist policies and liberalisation trends are closely linked to major economic and political changes. Table 1 provides a summary of the changes in policy direction and economic conditions. Furthermore, moves to deregulate, at least until recent times, often appear to be ad hoc rather than part of a systematic plan.

#### *Stabilisation Period: 1967-1972*

The "New Order" government undertook substantive liberalisation of the economy including trade and industrial reforms. The policy approach adopted by the New Order government contrasted sharply with the heavily interventionist policies of the Soekarno government. Reactions to the economic chaos left by the old government as well as the abuse of privileges accompanying public intervention in the economy, together with the influence of western trained economists meant that the new order government shifted economic policy away from direct control over the economy.

An open capital account with no foreign exchange control was introduced. The multiple exchange rate system was unified in 1970

and the Rupiah was devalued in 1971. As the focus shifted towards increasing domestic production, tariffs on some products were increased in 1968. Production increased, notably textiles, partly due to protection but also as a result of an open door investment policy.

The 1967 Foreign Investment Law was aimed to restore investors confidence and encourage private investment in priority sectors. It included a package of incentives through tax holidays, import duty and sales tax exemption on imports of machinery and equipment, accelerated depreciation, guaranteed repatriation of capital and profits, and provisions to carry forward losses. After a lot of persuasion the same benefits were extended to domestic investors under the 1968 Domestic Investment Law. Initially there were no restrictions on foreign equity and employment of expatriates and 100 per cent foreign ownership was allowed. The only restriction on foreign investors was that they were not allowed to distribute their own products in the domestic market.

The process of change was smooth and relatively swift since the new order government was concerned with restoring and rehabilitating an economy that had been producing at 20-30 per cent capacity, a badly damaged economic and physical infrastructure, very low levels of trade, negligible foreign exchange reserves and hyperinflation. The change in political power removed entrenched interests which are often an obstacle to reform.

#### *Oil Boom Years: 1973-1982*

The oil boom which began with the quadrupling of oil prices in 1973 and continued

Table 1

## CHANGES IN POLICY DIRECTION AND ECONOMIC CONDITIONS: INDONESIA

		1967-1972 Rehabilitation & Stabilisation	1973-1981 Oil Boom	1982-1985 Initial Oil Price Decline	1986-Now Rapid Oil Price Decline
Economic Setting	GDP	High Growth- 10 per cent	Mod. High Growth 7-8 per cent p.a.	Slow Growth 3-5 per cent p.a.	Slow Growth 3-5 per cent p.a.
	DSR	14-20 per cent	14-20 per cent	20-25 per cent	30-38 per cent
	Per cent Total Exports				
	Inflation	1-10 per cent (av.6)	10-47 per cent p.a. (av.20 per cent)	4-12 per cent p.a. (av.8)	5-9 per cent p.a. (av.7)
	Oil/Exports	60 per cent	60-80 per cent	60-70 per cent	50 per cent
	Manuf/Exports	1 per cent (av.1)	1-3 per cent	4-11 per cent	18-25 per cent
	Oil/Govt. Rev.	50 per cent	60-70 per cent	50-60 per cent	40-50 per cent
Macro	Fiscal (Rel.Prudent)		Bal. Budget; high Govt. Spending, Pertamina Debt	Austerity and begin Res. Mobiliz.	Continued Austerity & Res. Mobiliz.
	Monetary (Anti Infl.)	Tight	Steriliz. oil money-Cr. Ceilings; unsucces- ful	Tight  Deval. 1983-fiscal	Tight
	Exch. Rate	Unify Multiple exch. rates and Deval. 1971 Open Cap. Account	Deval. 1978-Dutch Dis. Begin 78- Manag. Fl.	Deval. 1986-BOP 1988-depreciation	Effective Exchange Rate Management
Industrial Policy		Initial Phases Import Substitution (final goods)	Continued Import Substitution (IS) (interm. and cap. gds.)	Continued IS- industrial deepen- ing; localization Beginning Exp. Or.	Export Oriented Strong Non Oil Exports Battle Cry
Trade Policy		Beginning Protection	Increased Pro- tection (some decline 1980) Mainly tariffs High and Var. ERP	Increased Pro- tection (increased use NTBs) Some Export Prom.	Decline in Protection Strong Export Promotion Some Mixed Signals
Investment		Liberal	Increasingly Restrictive	Still Restrictive	Fall in Restrictions
Financial		Open (incr. Comp.)	Closed; Banks channel Oil Money	Still Closed but Increased Com- petition	Open Increased Com- petition



high prices until 1982, dulled much of the government's resolve to institute reforms that would provide a greater role for the private sector. Instead there were more protectionist and interventionist policies.

Regulations regarding foreign investment became more restrictive. The open door policy to foreign investment and the first phase of import substitution in final goods led to a surge of foreign investments which responded to the incentives and to maintain their position in the domestic market. The high visibility of Japanese investment due to the concentration of their investments in consumer products led to strong anti Japanese riots during the visit of Prime Minister Tanaka in 1974. In fact the value of United States investment was much higher but it was concentrated in the less visible capital intensive oil sector.

In the aftermath, restrictions which reflected increased nationalist sentiments, were placed on foreign investment. All new foreign investments were to be in the form of joint ventures, Indonesian equity was to be increased within a specified period, the list of closed sectors was extended, tax incentives were reduced and the number of expatriate employees restricted. However, after much complaint from investors, in 1977, the administrative procedures for investment applications were simplified and the Board of Investment was made a "one stop service" so that an investor did not have to obtain approvals from other government departments. But during the second oil boom in 1979, foreign investment requirements were tightened once more by making the priority list more restrictive.

Trade and industrial policies during this period were directed at influencing the pat-

tern of industrialisation through the protection of domestic industries. As with other developing countries, Indonesia adopted an import substitution strategy beginning with final consumer goods and then moving to intermediate and capital goods. The regime that developed was characterised by escalating protection through tariff and non-tariff barriers, high and variable effective rates of protection which biased against export production, proliferation of administrative procedures and excessive government intervention.

However, macroeconomic policy was fairly sound during the new order period. It was characterised by concern for controlling inflation and prudent fiscal policy. Prudent fiscal policy is reflected in the balanced budget rule. Indonesia also did not borrow as heavily as other oil producing countries. The conservative foreign borrowing policy was related to a rule of thumb that the debt service ratio should not be above 22 per cent and caution resulting from the Pertamina crisis whereby the state oil company incurred debts of the order of US\$10 billion.

The government was less successful in controlling inflation. The substantial increase in money supply due to the spending of oil revenues could not be sterilised with the limited monetary instruments available. High levels of inflation of around 20 per cent per annum resulted. They contributed to a reversal of the terms of trade for non-oil goods, in response to which the Rupiah was devalued. The 50 per cent devaluation of the Rupiah in 1978 showed the government's willingness to react quickly to a change in economic conditions with appropriate real exchange rate management.



## The Present Deregulation Phase, 1982-Present

In this section the focus is on the present deregulation phase. Table 2 in Hadi Soesastro's current event article in this Third Quarter issue provides a summary of the reform measures. Reforms must be seen as part of the overall restructuring strategy in response to falling oil prices. The content and sequencing of policy reforms will be analysed, as well as the importance of macro economic stability in facilitating successful reforms.

Falling oil prices had important implications for Indonesia. There was a fall in foreign exchange earnings. Appreciation of the Yen, especially after 1985, worsened the balance of payments situation since around one third of Indonesia's foreign debt is denominated in Yen. Furthermore, around 60 per cent of government revenue came from taxes on oil corporations so that there was a substantial fall in government revenue available for development expenditures. Table 1 shows that government savings increased rapidly during the oil boom years but then fell substantially from the beginning of 1982.

In addition, at the time of the initial decline of oil prices in 1982, the economy was in an "overheated" condition with high levels of oil related public investments and upsurge in private investments. At the time the oil price began to decline other adverse external conditions were the world wide recession and the increase in interest rates due to the tight US monetary policy which affected the payment of Indonesia's debt service.

In the initial period of the oil price decline, the government response was ambivalent. While the need for resource mobili-

sation, increasing foreign exchange reserves through the promotion of non-oil exports and the increased role of the private sector were recognised, it took some time before political will became strong enough to push policy reforms. It was not until oil prices fell to US\$10 a barrel in 1986 that it became politically feasible to implement several of the policy reforms that had been present in the political economy debates for some time.

### *Ambivalent Period 1982-1985*

*Devaluation and Austerity Measures.* The government responded quickly in terms of exchange rate management and austerity measures. In March 1983 the Rupiah was devalued by 50 per cent. The devaluation was undertaken after much speculation which led to a significant anticipatory capital outflow. Devaluation was also undertaken for budgetary reasons, that is the nominal value of government revenues in Rupiah would show an increase despite the fall in the US Dollar price of oil. There was also the purported aim of increasing non-oil exports, but since the devaluation was not accompanied by the much needed deregulation in the real sector and was in fact accompanied by increased protectionist policies, the devaluation alone did not succeed in raising non-oil exports significantly.

Austerity measures came in the form of budget cuts and increased efforts to prevent leakages. Several capital and import intensive projects were postponed in 1983. Subsidies on domestic fuel, agriculture and state enterprises were reduced and eventually removed. More attention was also given to the disbursement of foreign borrowing with a commission being set up to look into the issue and undisbursed funds as a budgetary item was also removed.



*Resource Mobilisation Efforts.* The government also moved quickly towards efforts to increase the mobilisation of domestic funds from the financial sector and improved the collection of non-oil tax revenues. Significant reforms in the financial and fiscal sectors with the 1983 banking deregulation and the tax reforms of 1984 were implemented. In an effort to increase the efficiency of the banking system and mobilise funds, credit ceilings were abolished, liquidity credits were reduced and state banks were allowed to set their own interest rates on deposits. The tax reform was aimed at improving the collection of tax revenues from non-oil sources. The reform was undertaken in stages beginning in 1984 with the abolition of the withholding tax and the introduction of the value added tax. Subsequently income and sales taxes were rationalised.

*Increased Protection: use of non-tariff barriers.* In contrast to macroeconomic policies, trade and industrial policies were not liberalised but became more protectionistic. Quantitative restrictions on imports were increased under the approved importers system (*Tata Niaga Impor*) introduced in 1982.

Prior to this system importers who obtained a license from the Department of Trade were either general importers who could import all categories of goods or importer-producers who imported raw materials and intermediate goods necessary in their production. Quantitative restrictions took the form of bans<sup>1</sup> and explicit import

quotas on the import of foreign films, powdered milk and for some period of time raw cotton. The import of powdered milk by milk processing plants and raw cotton by spinning factories were tied to a fixed ratio of domestic supply.

Under the approved importer system introduced in 1982, goods listed in nine categories<sup>2</sup> could be imported only by approved importers, except for imports under the foreign and domestic investment laws, foreign aid agreements, government projects, service contracts and production sharing contracts. Initially two types of licenses were issued. The first general licenses (*Importer Umum*) under which an importer is approved to import goods falling into certain categories; an additional specific import license for each batch of imports is not necessary and the amount, type, and country of origin of the goods are not specified. However, the government can limit the number of approved importers to bonafide ones who satisfy certain requirements such as past performance and the hiring of skilled labour. These criteria however, were never made clear. At least on paper, importers are granted approval for two years, but they must report their realised imports every three to six months.

The second type of licenses are discretionary or specific. These are aimed at controlling the amount and type of goods entering the economy. Approved importers are eligible to apply for a license to import goods; this may or may not be automatically approved. The type or amount of goods im-

<sup>1</sup>The bans are on five groups of products. The bans were partly for political reasons (Chinese printed matter); partly health and safety oriented (drugs, chemicals) and also partly to promote the domestic assembly industries in the electronic and automotive field (completely built up motor vehicles and motor cycles).

<sup>2</sup>The nine categories are electrical and electronic goods; chemical products; metal industries; machinery and spare parts; heavy equipment and spare parts; motor vehicle components; textiles; agricultural products; and food, beverages and fresh fruits.



ported are specified so that there is a built-in quota under this system. It is possible for the government to specify a zero amount or not approve an import license. Under the approved importer system more goods were delegated to state trading and producing enterprises for their importation.

Prior to this system, imports of cement, fertilisers and some processed agricultural products such as wheat flour and cooking oil were imported by state enterprises. The main motivation had been price stabilisation of strategic commodities by ensuring adequate supplies. Another reason was protection by government owned corporations producing cement, flour and fertilisers. The reasons for the addition of goods to be imported by state trading and producing enterprises appear to be: to protect some domestic industries considered capable of satisfying domestic demand, to protect the production of state owned corporations; and to conserve foreign exchange. The additions include steel, kraft paper, scrap metal, tires, tin plates and plastic raw materials.

The purported objective of the approved importer system was a combination of protection and foreign exchange saving. Press releases and interviews with officials involved in the process, however indicated that another underlying objective was to increase the professionalism of importers. It was not the idea of the originators of the system that quantitative restrictions should develop. The idea was more to streamline imports and a bonafide importer could import all nine categories of products under the general importer category.

However, in the period of 1982-1986, especially 1983-1984, many licenses of the second type were issued. In addition to direct

balance of payments pressures, there was renewed support for import substitution industrialisation aimed at intermediate and upstream products such as iron, steel, synthetic fibers, cement, chemicals, fertilisers and motor vehicle engines. The underlying argument was that such an industrialisation strategy would relieve balance of payments problems. There was still general support for an import substitution strategy. Tariff levels were already high, but did not provide the required protection. Instead of increasing tariffs, not tariff barriers were increased because they were less visible.

As a result, several types of import licenses outside the general import licenses developed:

- Importer/producers who needed to import raw materials or intermediate goods (*Importir Produsen*);
- Agents licensed to import a particular brand of products (*Agen Tunggal*);
- Producer Importers or Producers who were the only ones approved to import products that they were also producing (*Produsen Importir*) such as Giwang Selogam on behalf of Krakatau Steel, the state owned steel mill which imports all steel products;
- The import of certain goods, for example plastic raw materials such as polyesterene and polyethelene, was designated to one or a number of the state trading companies (*Importir Terbatas*).

In 1986 it was estimated that 28 per cent of the total number of items imported, 26 per cent of the total import value and 31 per cent of value added were restricted under the approved importer system.

An important development during this period was the creation in 1983 of the Depart-



ment for the Promotion of Usage of Domestic Products (*Promosi Pendayagunaan Produk Dalam Negeri*). This Department was given the task of increasing the use of domestic products as part of the industrialisation strategy, thus enhancing the protectionist trend. There was an increase in non-tariff barriers and in domestic component or localisation policies whereby assemblers of motor vehicles, motor cycles and other equipment had to obtain a certain percentage of their components domestically according to a given time schedule.

The approval process regarding the second category of import licenses provides some insight to the process of policy making. The list of goods to be imported under this system, the amount of imports allowed and sometimes the fixed selling price of the product (such as steel products) are determined after a discussion between an interdepartmental team made up of the Departments of Finance, Trade, Industry and Promotion of the Use of Domestic Production (until the termination of this department in the new 1988 cabinet), business and industry groups. Examples of manufactured products affected are piston rings, automotive components, milk products, steel, white cement, inner tyre tubes, some dyes, heavy equipment, PVC, motor vehicle tyre tubes, hand sprayers, batik, textiles and glass sheets.

In theory a domestic industry which can show that it can produce a given product in sufficient quantity and of acceptable quality at a competitive price with imports, can petition for a limitation on competing imports through the inter-departmental team. The process is that the petition, which *can come* from an individual producer or from an industry association, will first be lodged with the relevant technical directorate in the De-

partment of Industry. The officials evaluate the petition by using information from the applicant, information from the users or consumers of the product, and their own information as well as discussions with relevant officials in the other Departments. A rough rule of the thumb that has been established is that the domestic price is competitive with imports if it is less than or equal to 15 per cent more than the import prices. The inter-departmental team can consider import restrictions if the customs duty does not exceed 20 per cent, agreement between producers and consumers is reached and the restrictions are temporary insofar as they can be lifted any time when there are supply shortages or price instability.

It is not clear whether the inter-departmental team has an official mandate below ministerial levels, although in many instances such Commissions or Investigations are accepted *modus operandi*. However, the inter-departmental team is an accepted informal vehicle for the flow of information in the decision making process for levels below the minister. However, whether or not informal co-operation works or not is apparently very dependent on the personalities involved.

At the departmental level a flow of information takes place formally through the weekly Department of Economic Co-ordination meetings. Informally it is achieved through the close co-operation that exists among the group of economic ministers that have been in office for most of the New Order government.

Despite the increased protectionist trend during the mid 1980, towards the end of the initial oil price decline period, two important and substantive reforms were undertaken with respect to tariffs and customs pro-



cedures. This marked the beginning of the deregulation drive stemming from the oil price decline. It was directed at increasing non-oil exports, increasing efficiency of the economy and greater participation of the private sector.

It is important to note that the problem of the popularly phrased problem of the "high cost economy" -- high costs due to protection, inefficiencies in the processing of government related regulations, and the inevitable abuses inherent in a highly regulated system -- was recognised long before the actual reforms were undertaken. The high cost economy problem received a wide press coverage. Studies measuring the high and variable rates of protection and the distortionary nature of protection were undertaken by both the World Bank, other foreign consultants hired by the government, as well as the research institutes attached to the universities.

*Tariff Reforms in 1985.* In 1985 the tariff system was rationalised substantially by an across the board reduction in the range and level of nominal tariffs. The range of tariffs was reduced from 0-225 per cent to 0-60 per cent and most tariff rates ranged from 5-35 per cent. The number of tariff levels was also reduced from 25 to 11. Despite the increase in non-tariff barriers during this period the rationalisation of tariffs must be viewed as a positive development.

The push towards reducing tariffs was already evident in the late 1970s and early 1980s. In fact in April 1979, in the wake of the 1978 devaluation the tariffs on 1,000 goods experienced a 50 per cent reduction and the number of imports subject to a specific tariff was increased for luxury items. However, for many goods which had expe-

rienced tariff reductions, subsequently there were increases as protectionist tendencies predominated.

Preparations of an across the board tariff reform along the lines of the 1979 tariff reductions began in the early 1980s and involved the research departments in the Ministries of Industry, Trade and Finance. Despite cabinet changes in 1983, the ministers and the co-ordinating minister were in agreement. The problem was timing. Falling oil prices and weak domestic demand made the arguments for reducing protection politically unacceptable. What finally made the reforms acceptable in 1985 was not the usual arguments of reducing protection by rationalising the tariff system, but was linked to the tax reforms on 1984. The argument being that a rationalisation of the tariff system was needed to make it consistent with the new value added tax.

Awareness of the problems of high and variable rates of protection, distortionary effects of protection, inefficiencies of domestic industries and the export bias, certainly existed at the time. The World Bank and HIID undertook several detailed and comprehensive studies quantifying the effect of protection in the early 1980s.

However, there was a time lag of several years before the actual substantive reforms were made.

*Customs Cleanup and Improvement of Shipping Regulations (Presidential Instruction No. 4).* In April 1985, all operations related to the import and export of goods by the customs department were totally disbanded in one bold sweep. The reform was undertaken to reduce the processing time and discretionary actions of customs officials. This had long been recognised as a major



problem and was often cited as an important element in Indonesia's high cost economy. Customs officials were replaced by a private Swiss surveying company, *Societe Generale de Surveillance* (SGS), at the point of importation. Estimation of the duty rate and value of imports is done at the point of origin of the goods and the importer pays the duty directly to his bank. Therefore, there was a reduction in the number of customs officials and discretion used at the point of entry.

Other parts of the Presidential Instruction No. 4 relate to deregulation of inter-island transportation, reducing documentation, rationalising port fees and allowing foreign carriers to operate more freely.

There appears to have been few transitional problems. In effect the change happened overnight. The customs officials whose services were not required were either shifted to other jobs or given early retirement with the normal official compensation. It is widely accepted and acclaimed that the average time spent on customs procedures has been cut by several weeks and the cost of shipping exports and imports has fallen substantially.

It is evident once again that while the problem of the customs procedures had long been recognised, as indicated by the open debate that occurred in the media, reforms took time. In this case, it was realised that it would be difficult to correct the existing institutional set up and the alternative chosen was to replace it completely. The idea of using a private surveyor company is not completely new. It has been used by other countries. Given that many people would be laid off and that it was essentially a privatisation move which involved foreign parties, the fact that such a bold move was accepted

indicates that the will to undertake reforms was beginning to be felt.

### **The Current Deregulation Phase (1986-Present)**

The sharp decline in oil prices that occurred in 1986 marked the turning point in the present phase of deregulation. Ironically the decline in oil revenues and deteriorating balance of payments situation provided the political will for substantive deregulation to take place. Indonesia is at the beginning of its deregulation process and export orientation strategy. At this stage deregulation is usually aimed at removing the bias against exports caused by the prevailing system of protection and not yet at removing the source of distortions.

#### ***May 1986 Package: Removing Export Bias and Encouraging Foreign Investment***

The first step in reducing costs for exporters was the customs cleanup in 1985. Subsequent deregulations were aimed first at offsetting costs to exporters either by simplifications of procedures or by allowing exporters special facilities. Second, deregulation was aimed at slowly dismantling the system of protection by starting with changing from non-tariff barriers to tariffs, which are considered to cause fewer distortions.

The 1986-1987 period can be seen to be one where the resolve to deregulate was very strong. In May 1986 a new and improved duty drawback and exemption system was introduced. Exporters can obtain a refund on the duty paid out on imports used to produce



exports or to get exemption from paying duties (this was introduced at a later stage), and are allowed to bypass the import monopolies as long as the import is used in export production. The old export certificate scheme introduced in 1978 was found to have an export subsidy component and since Indonesia became a signatory to the GATT Code on Subsidies and Countervailing Duties in 1985, the system had to be changed. Exporters were defined to be producers who exported 85 per cent or more of their total production. The unique feature of the new system is that applicants for duty drawback are not allowed to meet the officials processing their applications. Applications must be sent by mail or courier and all enquiries to be made through the telephone. The computerised and arms length application procedures were designed to reduce the abuses that existed in the old system.

Other important features of the new regulations for foreign investors were: up to 90 per cent foreign ownership is now allowed for export oriented investments, utilisation of low interest export credits, and joint ventures with 75 per cent more of Indonesian equity could undertake domestic distribution.

*Devaluation: September 1986.* In response to the plummeting oil prices in 1986, the government once again demonstrated its capacity to react quickly with exchange rate changes in response to a substantive economic change. The devaluation was undertaken despite the real possibility of political repercussions. Unlike the other devaluations (1978 and 1983) this one was regarded as successful in terms of increasing non-oil exports due to the control of inflation (the rate of inflation was around 9 per cent in 1987) and the deregulation measures undertaken. Dur-

ing 1988 besides keeping a low inflation policy mostly by adopting a tight monetary policy, the Rupiah was also depreciated with the objective of maintaining competitive real effective exchange rates.

An important feature of the 1986 devaluation which had an important bearing on subsequent policy measures was that the timing of the devaluation was unexpected. Given falling oil prices, devaluation expectations were strong. However, given that election was approaching and that various government officials indicated that a devaluation would not be undertaken, the anticipation was that devaluation would occur after the elections. The unexpected timing and earlier official statements stating the contrary, created a confidence crisis which was enhanced by rumours that private deposits would be frozen and exchanged for government bonds, and lack of clarity regarding various government policies.

One of the responses was to respond to foreign investors' demand for protection against foreign exchange risk. Thus, in October 1986 the swap ceiling was removed and since then any borrowing from abroad could be swapped. On the trade side, many non-tariff barriers were removed and replaced by tariffs in October 1986 and January 1987. The approved importers' system was also rationalised at the same time.

Several important policy packages aimed at improving the investment climate and to promote non-oil exports then followed. The various deregulation packages also contributed to the beginning to alleviate the problems associated with the high cost economy, but also indicated that the government is serious about improving the regulatory environment that producers must operate in.



*Investment Deregulation.* In June 1987 the investment and capacity licensing requirements for domestic firms were substantially deregulated. Prior to deregulation, renewal (varying between 2-5 years) and expansion in capacity necessitated reapplication to the Department of Industry. Under the new regulations renewal is no longer necessary and only expansion of capacity exceeding 30 per cent needs approval. Furthermore, the categorisation of licenses was considerably broadened in order to encourage diversification within the same type of product. Previously "closed" sectors under the Investment Priority list can now be opened if an investor is export oriented, that is, exporting 85 per cent more of their production.

*Rationalisation of the Textile Quota Allocation System.* In July 1987 the system of textile quota allocation to Indonesian textile and garment exporters was also improved. The main changes were aimed at reducing the discretionary powers of officials and reducing unnecessary administrative procedures and costs. The initial allocation is still based on past performance; the main difference is that the allocations are published in the media by company and allocation size. The fee to the Textile Association that was linked to the allocation of quotas was also removed. Unused quotas are now to be exchanged in the auction and quota holders are penalised by 20 per cent of the unused quota sold in the auction or 200 per cent of the unused quota if it is not sold in the auction.

One interesting feature of the reform of the textile allocation system is the preceding press coverage that it received. While the rationalisation plan may have already been in the minds of policy makers, the pressure from public debate probably had a strong in-

fluence. Encouraged by the success of the Spinners Association in obtaining the removal of the cotton import monopoly, the garment producers formed a new association in defiance to the existing Textile Producers Association. It was this newly formed association which lobbied for changes directly to the Ministry of Trade and indirectly by building up public support through the media. Despite improvements, exporters still feel that these are problems with regard to the lateness in allocation and the lack of transparency.

*December 1987 Package.* In December 1987 measures to reform capital markets were announced. Deregulation of the capital market was aimed at reducing government intervention in the operations of the stock exchange, such as limiting the rate of increase of prices, and to introduce over the counter trading. Foreigners are now allowed to purchase shares in the Indonesian capital markets.

Other important deregulations were: the simplifications of licenses for opening hotels; joint ventures are to be treated as domestic companies if 51 per cent of the equity is Indonesian or if 20 per cent of the shares are sold in the capital markets; joint ventures can export their own products as well as exports from other companies; the relaxation of the definition of exporter to exports being equal to 65 per cent more of the production; and export licenses, except for quota items, were eliminated.

The period from December 1987 to October 1988 can be classified as a period of ambivalence again where investors were not certain as to the direction of the deregulation. There was much speculation whether there would be further deregulation, when it



would occur and what the deregulation would entail. For example, rumours regarding the abolition of tax exemptions on interest on time deposits circulated for many months before the deregulation actually was undertaken in October 1988. Forces in favour of elimination argued that it was necessary to remove the disincentive to investing in the capital markets since dividends on capital gains were taxable and that such a step would also make the taxation system consistent and integrated. Forces opposing the move argued that such a deregulation would lead to huge capital outflows which may force Indonesia to devalue, so instead to remove the disincentive, taxes on capital gains and dividends should be removed. This alternative however was in conflict with the objective of rationalisation of the tax system and collection of non-oil tax revenues.

At the same time there was an increased use of exports bans on raw and semi processed products which appeared to counter moves to deregulate. The recent export bans pertain to raw and semi processed rather and webbed rattan. Furthermore, the purchases and distribution of rattan has been designated to the Association of Furniture producers. The export of some types of rubber and leather has also been banned.

*Substantive Reforms and a Clearer Direction.* After a lull of eight months, there were three major deregulation packages in the last three months of 1988. First was the long awaited deregulation package on the financial sector in October 1988. The main aim of the package was to increase competition between banks, thus increasing efficiency and reducing intermediation costs. Eventually it would reduce interest rates and increase the availability of investment funds which are crucial to the future growth of the

economy.

The deregulation comprised mainly of removing the restrictions on limiting the number of banks, both foreign and domestic. New domestic banks would be allowed, foreign exchange licenses were opened, new foreign banks can enter as joint ventures (up to 85 per cent equity) and the geographical and product (saving deposits) restrictions faced by existing foreign banks were removed. State enterprises are also now allowed to place deposits in non-State-Banks. Another important dimension of the banking package is the safety and soundness of the regulations regarding legal lending limits.

In order to remove the bias against investments in the capital markets and to also move towards a consistent tax system, the tax exemption on interest on deposits was removed. To offset the resulting increase in cost of funds, the reserve requirements of banks were lowered from 15 per cent to 2 per cent.

The second deregulation package, in November 1988, related to shipping, distribution of goods by foreign investors and non-tariff barriers. Regulations on routes and licensing of inter-island shipping were removed and the requirement to use domestically produced ships was relaxed. Foreign investors are now also allowed to distribute their own goods by setting-up a joint venture distributing company. Finally, further changes from non-tariff barriers to tariff barriers were initiated and in the two most important areas, raw materials for plastics and steel products. These two areas have been judged as the barometer of the seriousness of the government in undertaking deregulation. It was also announced that there will be three more deregulation packages in



investment, capital markets and state enterprises.

The third package announced on December 20 1988, was a capital markets deregulation and financial services package. The main components of the package are: allowing the opening of a private stock exchange, opening of stock exchange in other cities other than Jakarta, and improvement in the transactions in securities at the Jakarta Stock Exchange. Regulations which did not exist or were not clear in several areas of financial services such as hire-purchase, venture capital, Leasing, Brokerage, Credit Cards and Consumer credit were rationalised and clarified. New entry was also allowed in these fields. The final component is the long awaited deregulation of the insurance industry: new entry was allowed and various restrictions were removed.

### The Impact of Deregulation: A Preliminary View

The results to date are encouraging. Non-oil exports have increased substantially with growth rates of 31 per cent p.a. in 1987 and 35 per cent p.a. in 1988. The value of non-oil

exports was US\$8.6 billion in 1987 and US\$11.5 billion in 1988. The growth of manufactured exports was even more spectacular at 57 per cent p.a. in 1987 and 40 per cent p.a. in 1988. The share of non-oil exports out of total exports has also doubled from 31 per cent to 60 per cent over the 1978-1988 period, and the share of manufactured exports has increased from 2 per cent to 31 per cent during the same period. High growth rates can be expected when one begins from a low base. Future growth of non-oil exports will depend on further deregulations as well as the implementation of ongoing deregulations and new investment. Continued maintainance of the real effective exchange rate with a combination of inflation control a managed floating will also be important for non-oil exports. Investment growth based on investments approved by the Board of Investment (BKPM) has been positive.

The growth of both domestic investments (PMDN) and foreign investments (PMA) has been very high, especially in the last two years. The trend of increased non-oil exports is also reflected in the growth of planned exports planned exports for PMDN doubled to US\$7.5 billion while that of PMA qua-

Table 2

#### GROWTH OF APPROVED INVESTMENTS

	(Rp Billion)	(US\$ Million)	Planned Exports	
			(US\$ Million) PMDN	(US\$ Million) PMA
1984	2,009.9	1,162.3	n.a.	n.a.
1985	3,749.7	859.0	n.a.	n.a.
1986	4,416.7	826.2	1,756.5	240.2
1987	10,265.0	1,457.1	3,868.7	437.9
1988	14,664.4	2,675.4	7,542.9	2,256.3



drupled to US\$2.3 billion. This is indicative of the increase in export oriented investments that have really increased substantially. The allocation of funds to Indonesia from Japan, Taiwan, South Korea and Hong Kong due to increasing costs experienced in the country of origin, and the improved investment climate in Indonesia especially for exporters, explain the trend of the last two years.

Banking deregulation has led to increased competition between existing banks as evidenced by increased advertising and promotion, product differentiation such as the giving of prizes related to savings deposits, opening of new branches and interest rate competition. Three joint venture banks, two Japanese and one French, have been approved with several still in the pipelines, and over twenty new domestic private banks have obtained approval. Several major companies such as Zebra Taxis and Bakrie Brothers have gone public and there has been a substantial increase in activity in the stock market, especially with a high level of foreign interest.

## Conclusions

A major conclusion that can be drawn from the study on Indonesian policy reforms, especially in the post oil boom period, is the importance of sequencing policies, especially the importance of stable macro-economic policies. As Bhattacharya and Linn (1988) point out, trade and industry reforms cannot be analysed in a vacuum since there is increasing recognition that the design and implementation of trade policy is a complex task and is related to other overlapping policy instruments and objectives.

"Since it is not feasible or even desirable to undertake all reforms simultaneously, the co-ordination and phasing of policy reforms becomes one of the central issues in implementing trade liberalisation."<sup>3</sup>

If generalisations can be made, the Indonesian government has shown prompt response to an economic crisis by undertaking appropriate economic stabilisation policies, notably with respect to exchange rate adjustments, reducing the fiscal deficit and consistent monetary policy. Macro-economic stabilisation was then followed by resource mobilisation policies.

The 1983 devaluation was followed by budget cuts, banking deregulation and tax reforms. The 1986 devaluation was also followed by further banking and financial sector deregulation and increased efforts to collect taxes.

After resource mobilisation policies, policies to reduce the factors leading to the high cost economy or policies to increase efficiency were introduced. The policies are a combination of simplifications of administrative procedures and rationalisation of incentives. Interestingly enough the sequence has been first with reform in trade policies and then followed by reforms in industrial or investment policies. The government has shown a willingness to undertake drastic reforms to indicate its seriousness such as the customs clean-up and this has an important psychological effect outside of the economic effects. After reforms in the trade and industrial sectors, reforms in other areas such as transportation and domestic regulations followed.

This sequencing is evident after the 1983 and especially more so after the 1986 devaluation. Initial conditions of macro-economic stability and appropriate real exchange rate management are important pre-

<sup>3</sup>Bhattacharya and Linn (1988), p. 61.



cursors to further more substantive, and potentially more unpopular, trade and industry reforms. What still needs to be deregulated are domestic regulations such as land laws, provincial level regulations and so on. Of course the continued implementation of existing deregulation needs also to be continued and monitored.

A second important feature of policy reform in Indonesia is the role of a continuous group of core policy makers who work closely as a team. The *main* policy making must be attributed to them despite the existence of other factors. That trade deregulation did not follow after the 1983 devaluation could be attributed to the fact that the consensus, probably even amongst the technocrat group, was still heavily biased toward import substitution.

While the impact of a devaluation and deregulation has been positive on non-oil exports and economic growth, future and continued growth will depend on investment. Thus, the maintenance of a conducive investment climate through ensuring the transparency and efficiency of the regulatory regime; and the supply of funds from the banking sector and capital markets will be crucial. Efforts to restructure the economy and increase the quality and capability of investment human capital should also be undertaken.

Increased competition as a result of deregulation is already evident. As expected issues of increased foreign investment and distribution in the post-deregulation era still need to be addressed, and its implication and interconnectedness fully understood.

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# Recent Changes in the World Economy: Adjustments in Selected Countries

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**I**T MAY NOT BE an exaggeration to coin the 1980s as a turbulent period in the history of the world economy. Changes of major significance occurred in political, security and economic relations among nations, reinforcing each other to have the combined effects of a highly uncertain global economic environment. The major economies have adjusted to these numerous changes surprisingly well as reflected in the robust improvement of their performance. However, many problems remain unsolved as the adjustment to the rapid changes was by and large, adhoc in nature, while efforts towards an institutionalised reform proved to be fruitless. Old imbalances, such as the one dividing countries between the less developed (LDCs) and the developed ones in the East and in the West have widened than narrowed. Between the developed countries themselves, there arose different kinds of imbalances which have so

far been handled in a very adhoc manner, threatening to destabilise further the existing international economic order.

Any open economy is required to respond to the changes. In doing so, also due attention has to be paid to the responses of other countries. As the tendency towards bilateralism is growing, the process of adjustment becomes very complicated. Yet, the policy options available to most developing countries, especially the highly indebted ones, are limited. Indonesia and the Philippines belong to this group of developing countries. Given the far-reaching changes in the global economy, ASEAN countries are confronted with a fundamental question. Is there any thing that ASEAN can do to improve the effectiveness of regional economic co-operation in line with the export-led development each of the member countries adheres to? Or has regional economic co-operation in general and among developing countries with their small regional market in particular become irrelevant?

There is no short cut to answer these two

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questions. As will be discussed in the first section of this paper, the changes we have to deal with are too numerous and are fundamental in nature to allow an early prediction as to where they are likely to lead. While a greater opening is pursued in most countries as an important component of the responses to the changes, some countries tend to follow a different direction as will be discussed in the second section. As a result, ASEAN is confronted with an unstable environment, making it a necessity to reassess its present policy as will be discussed in the last section of the paper.

### Changes of Major Significance

The economic success of Japan is among the most important changes in the world economy of the 1980s. It is not easy to give a comprehensive picture of this success. Huge trade surplus, current account surplus, foreign direct and portfolio investment abroad, as one can see from selected indicators reproduced in Appendix A, and the replacement of the United States by Japan as the biggest contributor to Official Development Assistance (ODA), do not tell everything about Japan's economic achievements in the 1980s. Japan is said to have overtaken the other developed countries in some technologies, though continues to lag behind the United States in others. In terms of the number of industrial robots employed, Japan ranks highest today with the possibility of strengthening its leadership in the new future. In IC industry, Japan is also leading at the moment, though research on superconductivity appears to have advanced further in the United States. In the area of material technology, Japan is currently enjoying a leading position in fine or advanced ceramic in which a major breakthrough is expected to occur soon. Such a breakthrough

will not only reduce the need of Japan for traditional strategic materials such as cobalt, chrome, and platinum, but has also improved Japan's market competitiveness as important as that of motor vehicles where Japan has in fact established a competitive edge. Furthermore, the leadership of the United States in bio technology is being challenged by Japan. Aware of the importance of this technology, Japan has established access to American bio technology by taking over, outright or partially, American companies with a certain capability in bio technology. In short, Japan has either taken the leadership or narrowed the gap to other countries in the current technology race. Although the capability of Japan in basic research is generally perceived to be weaker than that of the United States and Europe, Japan technology image is no longer confined to that of a clever imitator. This is important in view of the very big contribution of technology progress to economic growth as underlined in recent studies like the one by Angus. Japan's success in a variety of industries demonstrates clearly that international competitiveness can be based either on comparative cost advantages or availability advantage.

That the success of Japan is much more than just current account surplus and related elements of wealth accumulation is clearly reflected in the shift in emphasis in the literature on international trade. While past work on international trade are dominated by the debate on free trade and protection, Japan's experiences have inspired economists as talented as Paul Krugman to theorise on strategic trade which, indeed, has become the major paradigm in recent works on international trade. The rest of the world is, indeed, currently involved in trying to emulate the Japanese model. Industrial targeting



is practised everywhere against the old wisdom of free movement of resources across industries and national boundaries. The economic success of Japan has, *de facto*, led to a new mode of trade conduct which is difficult to accommodate in the currently existing trade regime with the GATT as its major component.

The role Japan should play in international economic organisations constitutes only part of what is currently known as the internationalisation of Japan. The question boils down to the participation of Japan in the leadership of international economic organisations. The world cannot deny Japan this leading role. Yet, there are constraints to such a participation. Part of them relates to Japan's reluctance to assume a leading role as such a "graduation" may create difficulties with Japan's own ally, namely the United States. According to some Japanese officials, Japan still lacks the human resources which are needed for a leadership role. Of greater importance, however, are the costs which will arise from Japan's position as a leader. Japan's market is perceived to be too small to absorb those costs.

The Japanese success has some other global impacts such as the imitation of the Japanese corporate culture which is likely to proceed with some shocks in the imitating countries and which may work as another source of friction. The above discussion has, however, demonstrated that the economic success of Japan has brought about a number of changes which in turn necessitate changes in the international economic order. How such an accommodation will proceed is one of the major uncertainties facing the world today.

In the Eastern part of the Pacific, the United States which has decisively shaped the post-war world economy, is confronted

with tremendous difficulties in keeping its house in order. It is difficult to make a general statement on the performance of the US economy in the 1980s. The United States has enjoyed the longest robust recovery in the post-war period as can be seen from Appendix B. In terms of creating new jobs and overall reduction of unemployment, the US economy has also performed very well, though some observers tend to belittle this performance as it is accompanied by a decline in the average level of wages. Furthermore, the Reagan administration has proved to be successful in fighting inflation which used to preoccupy the United States and other developed countries in the 1970s. There are however some developments in the US economy which are of direct relevance to the management of the global economy.

The twin deficits are one of the worrying developments. It is widely agreed that the US cannot continue to accumulate its budget and trade deficits. Sooner or later, it has to balance its budget and current account. Indeed, the US has to earn a current account surplus in order to serve its huge external debts and foreign direct investments which entered the US in magnitude in the last few years. Such a transition from deficit to surplus may create problems somewhere else, especially in the developing countries including ASEAN, which so far rely heavily on the American market while pursuing their export led growth. Besides, it is by no means clear how the United States is going to reverse the trends in its budget and trade balance.

There is no consensus on the nature and causes of the twin deficits of the United States. Some tolerate these deficits as a necessary price for the good growth and employment performance and stress that the US economy is large enough to afford the



twin deficits. Others tend to attribute the deficits to a structural decline in United States' international competitiveness, and draw, accordingly, a gloomy picture, saying that the United States has no choice but to resort to drastic measures such as a sudden devaluation, if it is to correct its external imbalance.

While the debate on the twin deficits continue, the US government is put under severe pressures to come up with some policy responses. The keyword in this connection is "active policy" covering different areas of policy which, indeed, amounts to a new identity of the United States as a trading nation.

The determination of the US government to resist protectionist pressures is clearly reflected in its success to bring to fall a number of protectionist bills. However, this success has turned out to be only partial in nature. Repeated statements on the commitment to free trade cannot obscure the fact that the United States has accommodated some protectionist elements in its trade policy.

First of all, the move of the United States from free trade to fair trade is unmistakable. Arguing that at least part of its trade deficit is due to unfair practices by its major trading partners, especially Japan, the United States embarked upon a fair trade campaign with an extensive coverage of issues. The number of subsidies and dumping investigations increased, many of which proved to be groundless. The sector-specific negotiation which was aimed at a Voluntary Export Restraint proliferates as reflected in the separate agreement between the United States and Japan on integrated circuits. On the other hand, American trading partners are put under pressure to open up their allegedly closed markets. A "Trade Strike Force" was sent

to various countries to identify trade barriers which are of direct relevance to American export, to investigate the adequacy of intellectual property right legislation, especially with regard to American rights, to assess access of foreign companies to the services sector, and to identify trade-related investment measures (TRIMs). The findings of this "Trade Strike Force" are compiled in the thick report of the USSR on Trade Policy Estimates.

Secondly; there is a growing demand for reciprocity in the United States. Legally speaking, nothing is wrong in this demand as reciprocity is among the principles of GATT. However, the US campaign for reciprocity does constitute an important change. The fact that the GATT worked smoothly in its early days was due partly to the fact that the United States as the leader or hegemony was willing to make concessions, even if other members refused to do so because of "special conditions" prevailing in their respective economies. A reciprotarian United States means, in other words, that despite the absence of a leader in the GATT, a collective leadership or "bigemony" though is certainly conceivable. Such a collective leadership has, in fact, worked to some extent in the Tokyo Round. However, the refusal of the United States to play the role of the leader in the GATT is an important change. Moreover, the reciprocity sought by some elements in the American trade policy establishments is a specific rather than a general one. This is clearly reflected in the demand for bilateral balance in US-Japan trade, US-Korea trade or US-Taiwan trade. A consistent implementation of this policy would certainly mean a collapse of the world trade. Thirdly, there are some signs that the United States is fleeing from multilateralism to some sorts of



bilateralism. The fair trade campaign discussed earlier was conducted on a country basis, ignoring the GATT Panel as a mechanism for dispute settlement. The signing of the US-Canada Free Trade Agreement is another indication that multilateralism is losing its lustre in the United States. One can certainly argue that this agreement is in line with Article XXIV of GATT. However, this article is not a plea for regional integration. It is there as an intermediate step towards multilateralism and was originally adopted to make possible the participation in the GATT of countries which suffer from economic backwardness such as the war-damaged Europe at the end of the 1940s. A free trade association among developed countries violates at least the spirit of Article XXIV. It is ridiculous, for instance, that because of the EC, Spain or Ireland has to give a better treatment to West Germany than to Indonesia. The logic of Canada treating the United States better than Indonesia is also difficult to find.

To some extent, the United States has succeeded in getting the concessions it wants from its trading partners through bilateral negotiations. Therefore, there is reason to doubt the commitment of the United States to the ongoing Uruguay Round. Yet, it was the United States who introduced a wide range of new issues to this round.

In addition to the economic success of Japan with all its implications upon the world economy and the retreat of the United States from its traditional role as the leader of the GATT, there still is a long list of other changes which contribute to the reshaping of the world economy. South Korea, Hong Kong, Taiwan and Singapore have clearly gained in importance as trading countries, opening a new opportunity for Indonesia, Malaysia, the Philippines and Thailand to

diversify their trade. ASEAN countries themselves have managed to grow at a relatively high rate, though Indonesia and the Philippines have to live under a tight resource constraint. Appendix C includes some indicators of the growing trade importance of both East and Southeast Asia.

Less encouraging is the development in Western Europe. Facing the so-called "euro-sclerosis" and "hysteresis," Europe-12 failed to rediscover the merits of multilateralism. Instead, Europe as a preferential trading area is perpetuated through the adoption of the European Single Act in 1986 aimed at the establishment of a truly internal market among Europe-12. The formation of a preferential single market is likely to increase the relative attractiveness of Europe and, thereby, to lead to trade diversion in the wider sense of the word. As far as the external trade policy is concerned, however, little has been known so far about its possible changes. It is likely to retain the layers of preferential agreements as a major element in spite of the doubt about their effectiveness to bring about the desired results. There is no clear evidence for instance that the Rome Conventions have improved the performance of African, Caribbean and Pacific countries in the European market, though it can still be argued, that this performance might have been even weaker in the absence of the Rome Convention.

Given its preoccupation with the completion of the Single Market, it appears illusory to expect Europe to be a firm proponent of multilateralism. The same applies to the socialist countries. The Four Modernisations of China have certainly improved the attractiveness of this country as a trading partner as reflected among others, in the substantial increase in the Pacific trade of China. *Glasnost* and *perestroika* in the Soviet Union



are also likely to have the same effects. However, these two giants are handicapped in respect of participation in the global economy. Part of the handicaps lie in the disagreements on either the direction or the speed of the economic reform. For example as long as prices are centrally administered, both China and the Soviet Union will not be "GATT compatible." On the other hand, the rest of the world has to some extent an aversion against trade with socialist countries given the latter's insistence on counter trade at a time when trade as usual can be continued with countries which, in terms of market size, are by far bigger than the socialist countries. Nevertheless, ASEAN countries should not underestimate the importance of the changes initiated by China and the Soviet Union, however limited the room is in the short-term to expand trade with these two countries.

As far as ASEAN countries are concerned, changes in Japan, the United States, the NIEs, Western Europe, China and the Soviet Union are the most relevant to be followed. However, solidarity with the rest of the developing countries and the fact that the outcome of international negotiations on a number of economic issues is strongly affected by conditions prevailing in Africa, South Asia, the Middle East, Latin America and the South Pacific Islands, make it a necessity for ASEAN countries to take into account the position of these groups of countries while formulating responses to the changed world economy. Of particular relevance to recall here are the persistence of underdevelopment in most developing countries and the debt problems. Interdependence as it exists today remains basically a one-sided dependence in the cases of most developing countries. Progress through trade and financial assistance has mate-

rialised only in a small number of countries, notably East and Southeast Asia, implying that other measures are needed if the world is serious about interdependence.

## Adjustments to the New Conditions

The numerous changes discussed earlier has set forth an adjustment in different parts of the world. Some commonalities are apparent in this process of adjustment. Greater openness is increasingly appreciated and a less interventionist state deemed as a necessary part of the adjustment, even in China and the Soviet Union as reflected in the wider autonomy granted to enterprises. Policy consultation or even co-ordination is sought, if remains without major success so far. Furthermore, the reliance of economic development on technology progress is increasingly recognised. Indeed, we seem to suffer from some kinds of "technology mania" which in some cases result in an ambitious technology programme under a severe resource constraint. However, there exist also differences. The United States attaches for instance a much greater importance to the protection of intellectual property rights compared to most developing countries, creating another problem for negotiation. Moreover, resistance to policy changes persists in most countries though it differs in nature and degree from one country to another.

Facing a growing imbalance between the United States on the one hand and the rest of developed countries on the other, a currency realignment was orchestrated by the G-5 in 1985. The result was a rapid depreciation of the US Dollar against other major currencies, but also against the Won, the NT Dollar, and the Singaporean Dollar. The keyword is "managed intervention" agreed out-



side the International Monetary Funds, implying that it was done on an adhoc basis. The extent to which this mechanism can continue to function is difficult to judge. What is certain is that the recent experiences in the management of exchange rate has revived the debate on a "new Bretton Wood system," meaning that the floating exchange rate system which was expected to correct trade imbalances automatically, is being questioned. Furthermore, the G-5 mechanism is inadequate as it may not take into account the interests of countries which are not party to it.

Another major adjustment is in the area of trade. At this juncture, it is important to note the growing appreciation of freer trade by developing countries. Plagued by an abrupt decline in commodity prices, many developing countries have shifted to an export-led development strategy with a strong reliance on manufactured products. As export of these products rely on imported intermediate products, trade liberalisation becomes a necessity. This is one of the important reasons behind the trade liberalisation initiated by most ASEAN countries in the 1980s. Ironically, by the time the developing countries discovered the merits of freer trade, the global trading system has been eroded to a very large extent. Negotiation turns out to be very difficult as a large number of issues to be addressed are to be found in the "grey area." Nevertheless, the need for negotiation is clearly felt, however difficult it has turned out to be to make the ongoing Uruguay Round a success.

The debt issues are of no less importance. There is a growing recognition that the present policy of debt rescheduling cannot lead to a lasting solution. None of the rescheduling countries has come out of the debt

crisis. Therefore, debt relief is sought by a growing number of debtors. In the meantime, some prominent economists have argued that debt relief can benefit both debtor and creditor. Even creditor governments, including the United States have learnt to appreciate the concept of debt relief, though Japan has kept silent so far. ASEAN countries, too, have never seriously discussed the idea of debt relief, partly because of the relatively favourable resource position enjoyed by these countries with the exception of Indonesia and the Philippines, but also perhaps because of the fact that Japan is by far the main creditor of these countries.

Increased efforts towards closer economic policy consultation and co-ordination constitute another important part of adjustment to the changed world economy. Never before has the world felt the interrelationship between issues as strong as in the 1980s. A great number of countries have benefited from increased export to the United States induced by the increase in income of the average American when taxes were cut by the Reagan administration. Likewise, Indonesia has to shoulder a sudden increase in debt stock and debt burden in the wake of the Plaza Hotel agreement among the G-5. Therefore, the need for policy co-ordination is widely felt, though most countries hesitate to join such a co-ordination for reasons related to national sovereignty.

Some exercises of policy consultation and co-ordination can be mentioned. The G-7 is perhaps the most prominent of them, though some analysts suggest that a true co-ordination has rarely taken place. An exception was the Bonn Summit in 1978 where a "locomotive model" of co-ordination was agreed with a disappointing result. This experience is frequently quoted as a case for co-ordination with a negative outcome, im-



plying that policy co-ordination is not necessarily a good thing. In an indirect way, other countries too, try to convey their concerns to the G-7. ASEAN did the same thing several times through a meeting with officials from one of the G-7. The effectiveness of this approach is doubtful, however.

Among the members of the EC-12 policy co-ordination has in fact become an important part of the policy agenda. In the monetary sector there is the European Monetary System. The same applies to nuclear technology. However, inadequacy in co-ordination is still even felt in the EC-12. In the Asia-Pacific, embryonic fora for policy consultation and co-ordination have also emerged. One of them is the Pacific Economic Co-operation Conference (PECC) which includes government officials in its tripartite participation. This forum has been criticised for being slow in making progress. As a result, there is a growing demand for a forum between governments as reflected in the recent campaign by the Prime Minister, Bob Hawke of Australia and Japan's MITI for an OECD-type organisation among the Pacific countries. However, a true policy consultation and co-ordination on a global scale remain a very remote possibility, notwithstanding the growing recognition that such co-ordination is badly needed.

### **Implications for ASEAN Economic Co-operation**

Individually, ASEAN countries have responded relatively early to the changes in the world economy as some of the changes had hit these countries in one way or another. In 1986 for instance, Singapore introduced a new policy direction which includes even a decline in wages for the sake of international

competitiveness. Malaysia has also engaged in some policy reforms including a more flexible implementation of its New Economic Policy. The Philippines has had a reform programme even before the present government came to power, though the implementation of the programme was delayed because of renewed demand for protection from the domestic industry. Brunei has also realised that it cannot rely on oil forever and is currently in the process of finding a diversification policy which suits its resource endowment best. Economic reform has also proceeded steadily in Indonesia. A big number of deregulation covering industrial and trade policy, investment policy, banking system, policy on capital market, tax policy and some specific sectors such as shipping and other trade-supporting services, have been announced especially since 1983. The phenomenal improvement in the economic performance of Thailand in recent years suggests that this country is equipped to benefit from the changes in the global economy.

There are some common features in the economic reforms undertaken recently in the ASEAN countries. First of all, they all aim at the diversification of the respective economies in terms of both production and trade. Secondly, they include a reduction or rationalisation of protection, reducing incentives to inward-looking activities in favour of export-oriented ones. Thirdly, a greater reliance on the private sector is being sought. Even privatisation is no longer a taboo. However, these reforms occur basically without prior consultation. The areas in which ASEAN seeks a common position is limited in number and importance.

It is difficult to judge on the role ASEAN economic co-operation should play in the new world economic environment. Some de-



velopments tend to favour a closer economic integration and co-operation while others do not. First of all, ASEAN has been taken seriously in various international fora in spite of its shortcomings as an economic group. In other words, it has become an asset that the member countries can make use of in dealings with issues of common interest. Any sign of weakening commitment to it is likely to impose unduly high costs to the member countries. Secondly, at a time when economic regionalism, as reflected in the Europe 1992, the Free Trade Agreement between the United States and Canada, the Closer Economic Relations between New Zealand and Australia, each with possible extension to other areas, ASEAN would be swimming against the current if its member countries move away rather than towards closer integration. Thirdly, the fact that the economies of ASEAN are showing improved performance and that their structures have become more diversified, point out to a growing potential for intra-industry trade. As industrialisation and wages move at different speed, inter-industry trade is even likely to widen in the future. Fourthly, there is agreement among the ASEAN countries that ASEAN has become an important variable in their respective foreign policy. A disengagement from ASEAN is very likely to destabilise the region as it may force each of the member countries to seek alliance with extra-regional powers. At this particular moment, ASEAN can still keep itself busy with the Kampuchean problem. But this problem is likely to be solved soon with or without ASEAN's support. Therefore, economic integration and co-operation need to be looked into with greater seriousness if ASEAN is to remain feasible in the future.

Among the factors which tend to suggest a declining relevance of ASEAN is first of

all, the growing reliance of each of the member countries on extra-ASEAN markets. If a country adheres to an export-oriented strategy, its interest would be served best if it goes to the largest market available. Seen from this angle, the important market for individual ASEAN countries is clearly the United States, Japan and the Asian NIEs. However, even under these circumstances ASEAN economic integration and co-operation can still perform a useful function. A freer intra-ASEAN trade will provide incentives for a deeper division of labour among the member countries and, thereby, help to improve competitiveness in the international market. Furthermore, market diversification is good even if it incurs some costs. Given the present performance, the ASEAN economies are gaining in importance. No one for instance predicted at the end of the 1970s that South Korea and Taiwan would become important trading partners of Indonesia as early as 1980s. Yet, these two economies have become a major destination of Indonesia's export and a major source of foreign direct investment especially in the last two years.

It follows from the above that ASEAN economic integration and co-operation can contribute to the attainment of the overall policy objectives its members are seeking. At least, there is no reason which speaks apriorily against closer economic integration and co-operation among the ASEAN countries. The last Manila Summit was in fact a renewal of commitment to ASEAN integration and co-operation as reflected in the adoption of a five-years programme to widen the coverage of the ASEAN preferential trading arrangement and deepen its margin of preferences. The same applies to the agreement on ASEAN Industrial Joint Ventures. Products of the AIJV are to enjoy a 90 per cent



margin of preferences in the participating countries. However, the Manila Summit left various issues untouched. Among others the most important pending issues include the machinery. The idea of equipping ASEAN with a Council of Ministers was turned down, implying that ASEAN is to remain as the business of foreign ministers. The ASEAN Secretariat is also to remain a technical one, in spite of the need for an independent body which is authorised to take care of a consistent implementation of the integration and co-operation programmes and to help settle any dispute on issues related to agreed programmes.

In addition to these pending issues, ASEAN is challenged to improve its dialogue mechanism. The coverage of this dialogue is needy of rethinking in view of the

new reality of ASEAN's external trade. South Korea and China have clearly been growing in importance as trading partners of ASEAN, and this development needs to be taken in future dialogue. Dialogue with the present dialogue partners is open to improvements. ASEAN should not put itself at the receiving end of such a dialogue and be satisfied with the inflow of assistance resulting out of it. The dialogue should rather be used as a forum for policy consultation. For that purpose, it needs to be upgraded into a multilateral forum. By so doing, ASEAN can seek the best concessions from its dialogue partners and, at the same time, reduce the pressure to have a new government forum in the Pacific which because of the political implications of the participation of developing countries, is likely to become an exclusive club among the more or less homogeneous developed countries of the Pacific.

#### Appendix A

##### SELECTED INDICATORS OF RECENT PERFORMANCE OF US ECONOMY

	1984	1985	1986	1987
Growth of Real GNP	6.8	3.0	2.9	2.9
Growth of Fixed Cop. Formation	16.8	5.5	1.8	0.7
Growth of Export (Goods + Services)	6.8	-1.7	3.3	12.8
Growth of Import	23.9	3.9	10.5	7.3
Net Household Saving, % of Disp. Y	6.3	4.6	4.5	3.9
Gov. Financial Deficit, % of GNP	-2.8	-3.3	-3.5	-
Unemployment Rate	7.5	7.1	7.0	6.2
Current Balances, \$ Bio	-107.0	-	-141.0	-161.0
Direct Inv. Abroad, SDRs Bio	-3	-17.0	-24.0	-34.0
Portfolio Inv., SDRs, Bio	25.0	66.0	70.0	49.0
Direct Inv. in US, SDRs Bio	25.0	19.0	29.0	32.0



## Appendix B

## SELECTED INDICATORS OF RECENT PERFORMANCE OF JAPAN'S ECONOMY

	1984	1985	1986	1987
Growth of Real GNP	5.1	4.9	2.4	4.2
Growth of Fixed Cop. Inv.	4.9	5.8	6.0	10.3
Growth of Export	17.5	5.6	-5.2	3.5
Growth of Import	11.1	-0.1	2.2	9.1
Net Household Saving, % of GNP	16.0	16.0	16.6	16.6
Gov. Financial Deficit, % of GNP	-2.1	-0.8	-1.1	-
Unemployment Rate	2.7	2.6	2.8	2.8
Current Balances, \$ Bio	35.0	-	86.0	87.0
Direct Inv. Abroad, SDRs, Bio	-6.0	-6.0	-12.0	-15.0
Portfolio Inv., SDRs, Bio	-24.0	-41.0	-86.0	-71.0
Direct Inv. in Japan	-	0.6	0.2	0.9

## Appendix C

## DIRECTION OF ASEAN TRADE 1987, %

.to from.	ASEAN	Japan	US	EC	Korea	H. Kong	China	World (\$)
Indonesia: x	6	44	20	9	4	3	3	16,548
m	7	33	9	22	3	4	2	10,234
Brunei: x	22	60	1	3	10	0	0	1,796
m	38	3	8	42	0	0	0	1,297
Malaysia: x	24	20	17	14	5	3	2	17,939
m	21	22	19	13	3	2	3	12,708
Philippines: x	9	17	36	19	2	5	2	5,649
m	9	16	22	12	3	4	3	7,144
Singapore: x	23	9	24	12	2	6	4	28,692
m	21	20	15	12	3	3	4	32,559
Thailand: x	13	14	18	21	1	4	3	11,727
m	16	26	12	16	2	1	4	12,964
ASEAN: x	18	21	21	14	3	4	2	82,351
m	17	23	15	15	3	3	4	76,898

Source: IMF, *Direction Trade*, Year Book 1988.



# Party Conflicts under the New Order: Patterns and Tendencies

*Sjamsuddin HARIS*

**C**ONFLICT is basically an inseparable part of societal life. Differences of opinions, views, interests, visions and perceptions are some of the many differences which may become potential sources of the development of a conflict. There is even a general trend that the more society develops the more varied become the characteristics and pattern of its conflicts.

Apparently the history of Indonesia's society and the development of her politics are no exceptions to these tendencies. There were times when certain groups in society had different and even conflicting views and outlooks. And there were times when they were united, going hand in hand in achieving their common goals. Alfian even identified that one of the interesting features of Indonesia's political developments since the time of national reawakening has been the continuous struggle through conflicts and consensus.<sup>1</sup>

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This article is translated from *Analisa*, XVII/5 (Mei 1988).

<sup>1</sup>Alfian, *Pemikiran dan Perubahan Politik Indonesia*, 3rd. ed. (Jakarta: Gramedia, 1981), hal. 59.

Should one observe the period prior to or after Indonesia's independence, there were the struggle for influence and power in which conflicts of interests were such that reconciliation is difficult. Among the nationalists, for instance, the sharp difference of opinions between Sartono and Hatta-Sjahrir in the beginning of 1930, followed by rumours on the dissolution of PNI (*Partai Nasional Indonesia* - the Indonesian Nationalist Party), after Soekarno's detention, had generated two new parties, the Partai Indonesia (*Partindo*) and the PNI Baru<sup>2</sup> (*Pendidikan Nasional Indonesia* - Indonesia's National Education). What was experienced by the Islamic group was not much different. Among Islamic circles there were controversies with regard to co-operation and non co-operation, between *Penyadar* and *Partai Serikat Islam Indonesia* (PSII) in 1936, between PSII of Abikusno and PSII of Kartosuwirjo in 1939, between *Permi* and *Persatuan Islam* (Persis) with PSII and even be-

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<sup>2</sup>See, John Ingleson, *Jalan ke Pengasingan: Pergerakan Nasionalis Indonesia Tahun 1927-1934* (Jakarta: LP3ES, 1983) esp. Chapter VI, pp. 158-195.



tween *Muhammadiyah* and *Nahdlatul Ulama* (NU) concerning matters related to *khilafiyah*.<sup>3</sup> The conflict within PSII was apparently so tremendous that Maswadi Rauf, for instance, observed that PSII experienced four major splits through just the 1930s.<sup>4</sup>

After Indonesia's independence, the types of conflicts became more diverse. Conflicts no longer occurred internally as was the case within the *Partai Majelis Syuro Muslimin Indonesia* (Masyumi) which led to the exit of PSII<sup>5</sup> in 1947 and NU in 1952.<sup>6</sup> Conflicts also developed between the parties. The difference of views between Masyumi and PNI was an interesting case in point of polarised competition among the parties during "the period of Liberal Democracy"\* which also involved other parties collaborating with both parties.<sup>7</sup>

<sup>3</sup>See Deliar Noer, "Islam dan Politik di Indonesia 1965-1970," *Prisma*, August 1979, p. 4.

<sup>4</sup>Maswadi Rauf, "Partai Serikat Islam Indonesia 1965-1970." Academic thesis in Social Science, University of Indonesia, 1971. On PSII also see Deliar Noer, *Gerakan Modern Islam di Indonesia 1900-1942* (-Jakarta: LP3ES, 1980).

<sup>5</sup>According to Maswadi Rauf, PSII never quit from Masyumi since organisationally PSII has never been part of it. This differs with Herbert Feith who sees the exit of PSII was due to the disagreement on Natsir's leadership. See Rauf, "Partai Serikat Islam Indonesia" and Feith, *The Decline of Constitutional Democracy in Indonesia* (Ithaca, New York: Cornell University Press, 1962), p. 139.

<sup>6</sup>*Ibid.*, pp. 233-236.

\*Editor's note: Refers to the period between August 17 1950 and June 5 1959, when Dutch style multi-party parliamentary democracy was practised, in accordance with the 1950 Provisional Constitutions.

<sup>7</sup>*Ibid.*

\*\*Editor's note: The period between June 5 1959, the time President Soekarno decreed the re-enactment of the 1945 Constitution and subsequently lead a presidential government system, and Mr. Soeharto's advent to the presidency, in 1968.

Unlike the previous two periods, the period of "Guided Democracy"\*\*\* tended to eliminate internal conflicts as well as between parties. However, the issue centred on conflict between the military, particularly the Army, and the *Partai Komunis Indonesia* (PKI) both of which endeavoured to woo Soekarno. After the end of this period, internal conflicts were again afflicting party life. Rivalries between the "radical" group (supporters of Soekarno's ideas) and the "moderate" group (who accepted the New Order) within the body of PNI constituted the profile of a conflict pattern following Soeharto's appearance on the political stage.<sup>8</sup>

In order to cope with these differences among parties, in early 1973 the New Order government pursued a policy of simplifying parties, through their fusion. It was hoped that rivalries between parties and political organisations would thus diminish. However, although conflicts among parties almost disappeared, conflicts still prevailed within the new formation. This was particularly experienced by the *Partai Persatuan Pembangunan* (PPP) and the *Partai Demokrasi Indonesia* (PDI), two parties that resulted from the merger of nine parties.<sup>9</sup> These two parties were so frequently entrenched in internal conflicts that it seemed like conflicts had become an inseparable part of their existence in the political arrange-

<sup>8</sup>Re: conflict within the body of PNI at the beginning of the New Order, see for instance, Nazaruddin Sjamsuddin, *PNI dan Kepolitikannya* (Jakarta: Rajawali, 1984).

<sup>9</sup>Parties fused in PPP are: Parmusi, NU, PSII and Perti, fused into PDI are: PNI, Partai Katolik, Parkindo, IPKI and Murba. For the process of the fusion see, A. Samsuddin, et.al., *Seri Berita dan Pendapat Pemilihan Umum 1971* (Jakarta: Lembaga Pendidikan dan Konsultasi Pers, 1972), pp. 16-18.



ment of the New Order.<sup>10</sup>

This essay attempts to look at the sources and nature of party conflicts<sup>11</sup> that occurred during the New Order, especially since their merger up until the 1988 General Session of the People's Consultative Assembly. Based on that, it also will look upon the pattern and tendency of those conflicts compared to, for instance, past party conflicts.

## Source and Nature of Conflicts

Usually the concept of conflict refers to the differences and conflicts of interests, opinions, ideas or perceptions, either in the form of violence, or to a lower degree, of non-violence.<sup>12</sup> The notion of conflict as covered by this essay comprises differences and controversies which are of a low level nature. In general, a conflict may originate from whatever factor differentiates a person or a group of people from one another in a common situation.

According to Mark and Snyder,<sup>13</sup> fragmentations or conflicts can emerge out of

<sup>10</sup>Concerning the conflict within the body of PPP, see for instance, Sjamsuddin Haris, "Konflik NU-MI dalam PPP Menjelang Pemilu 1982," Academic thesis for Political Science, National University, Jakarta, 1984. For conflict within PDI, read for instance, Manuel Kaisiepo, "Dilema Partai Demokrasi Indonesia: Perjuangan Mencari Identitas" in *Prisma*, No. 12 (December 1981), pp. 68-83.

<sup>11</sup>The term "Konflik Partai" is used as conflict has become the focus as what has happened within PPP and PDI. The study on Golkar is not included in this essay.

<sup>12</sup>See a.o., Albert F. Eldridge, *Images of Conflict* (New York: Martin's Press, 1979), p. 2. Compare with Alfian, *Pemikiran dan Perubahan Politik*, pp. 59-60.

<sup>13</sup>Marck and Snyder as referred to by Dennis C. Pirages, *Stabilitas Politik dan Pengelolaan Konflik* (Jakarta: FIS-UI, 1982), p. 7.

the scarcity of positions and resources. The fewer the availability of positions and resources for members or groups of members to gain, the keener the conflict and rivalry to control those positions and resources. It is further argued that: "In any social hierarchy there are only a limited number of real positions of power and there will not be more than one person who can occupy each position. Likewise, there are just a few examples of social units, where the provision of needs is so abundant that all the parties can meet their desires."<sup>14</sup> In cases in which the positions and resources available are not equal to the number of people wanting to occupy those positions and to obtain those resources, there is a great possibility for conflicts too.

Meanwhile, David Schwartz has expounded that conflicts can also be triggered by political alienation. According to Schwartz, political alienation is experienced by individuals or groups at the time they realise that their values differ and are in conflict with those pursued by both the political system and the government.<sup>15</sup> Schwartz meant that a difference in perception with regard to political change may become one of the sources of a conflict.

Political ideology is another source which may spark and develop a conflict within an organisation or party. According to Duverger,<sup>16</sup> political ideology -- in the sense that ideology is related to the essence

<sup>14</sup>*Ibid.*

<sup>15</sup>Schwartz as referred to by Eldridge, *Images of Conflict*, p. 114.

<sup>16</sup>Maurice Duverger, *Sosiologi Politik*, translated by Daniel Dhakidae (Jakarta: Rajawali, 1982), p. 267. Compared to Reo M. Christenson et.al., *Ideologies and Modern Politics*, 2nd ed. (New York: Dodd, Mead, 1975), pp. 3-20.



of authority and its implementation -- while having the tendency to unite a community, can also be divisive when several ideologies are assembled together, depending to what extent each ideology is supported by one of the factions in the community. In this context, Duverger identified that within ideological groups, such as in a political party, the political ideology of each group that has been merged in it may constitute a source of antagonism or conflict.

Therefore, conflicts can develop and have their source in: (1) limited positions and resources; (2) political alienation; and (3) difference of political ideology. These three sources, with different emphases, seem to be the causes of the protracted conflicts occurring within the organisations of PPP and PDI after the 1973 reorganisation of party life through fusions. Besides the three internal factors, conflicts within the PPP and PDI organisations also were influenced by external factors such as intervention by a third party. According to Dennis Pirages,<sup>17</sup> intervention by third parties did not help much in finding a solution to the conflict. On the contrary, empirical study has shown how small a preference for using bargaining to a solution to a conflict. In this context the third party, that is, the government, is seen as an intervening variable which influences the intensity of the party's conflict.

Duverger has defined three types of conflicts. The first is conflict which is not based on any principle, the second is a conflict which occurs because there are differences in terms of parts of a principle but not the principle itself, and the third is a conflict which originates completely from the basic prin-

ciple.<sup>18</sup> The characteristic or nature of the first type of conflict is related to practical matters which have no connection with ideological ones. A difference of opinions emanating from practical political interests of a person or a group of people being in conflict can be included in this category. The second type of conflict is concerned with differing views on a matter related to the party's or community's interest regarded as being represented by the party. A difference of attitude and views related to the policy of the party in terms of matters related to the general interest can be included in this category. The third type of conflict emerges when the matter being disputed is an ideological one, such as when it concerns the foundation of the state. The conflicts within the bodies of PPP and PDI were apparently concentrated around the first and second types of conflict, if seen from Maurice Duverger's categorisation.

## Parties in the New Order Political System

It is its commitment to the implementation of economic development that makes up the framework to perceive the direction taken by the government during the last two decades in restructuring political life. The restructuring of political life is considered a very logical and natural imperative to safeguard and maintain stability.<sup>19</sup> Within this context, the renewal of party life and the de-

<sup>18</sup>Duverger, *Political Parties* (1963) as referred to by Arbi Sanit, *Sistem Politik Indonesia: Kestabilan, Peta Kekuatan Politik dan Pembangunan*, 3rd ed. (Jakarta: Rajawali, 1984).

<sup>19</sup>For this, see, Ali Moertopo, *Strategi Politik Nasional* (Jakarta: CSIS, 1974).

<sup>17</sup>Pirages, *Stabilitas Politik*, pp. 57-58.



mand for a more stable political system that can secure the continued improvement of economic life, basically justify such a world view.<sup>20</sup>

The place of parties within a national political system -- which should constitute virtually an institution accommodating participatory functions as well as political communications, articulation and aggregate of interests, political socialisation, policy making, political recruitments, and as a means to solve conflicts, as is generally known in the West,<sup>21</sup> -- instead has changed primarily into a "governmental partner" within the political order being developed. Therefore parties are one of the "basic assets of development."

The bid to strengthen and clarify the parties unique position not only reduced the number of parties, but also created the "distance" between parties and rural communities (through the concept of the floating mass), as well as between the parties and the bureaucracy (through the concept of monopoly). The "current politics" pattern<sup>22</sup>

<sup>20</sup>Political stability as a prerequisite for economic development constitutes one of the concepts as developed by Western theoreticians on political development in order to analyse changes in developing countries. See, for instance, Lucian W. Pye "The Notion of Political Development," in Juwono Sudarnono, ed., *Pembangunan Politik dan Perubahan Politik*, 3rd ed. (Jakarta: Gramedia, 1982), pp. 15-30.

<sup>21</sup>For the function of parties, see, Meriam Budiardjo, ed., *Partisipasi dan Partai Politik* (Jakarta: Gramedia, 1981).

<sup>22</sup>"Political Currents" are political patterns born from a network of a corporation among parties, social organisations which form the sub-organisation of parties and the masses which have been established on the bases of primordial ties, such as religion, ideology, kinship, language, and ethnic affiliation. For this, see Clifford Geertz, *Abangan, Santri and Priyayi dalam Kebudayaan Jawa* (Jakarta: Pustaka Jaya, 1980).

which has developed in the past within the party life seems to be the source of concern that has become the New Order government's reason to limit the involvement of parties.<sup>23</sup>

The course of that restructuring process brought about a number of other problems. First, the position of parties became so dependent on the course and tendencies of national politics that it is no longer deeply rooted. Second, it is difficult in party circles to identify the essence of their presence in the existing political order in force, the more so if it is related to the party life in the past which was not quite satisfactory for the New Order government. Conflicts within the

<sup>23</sup>However although those limitations apply to either PPP, PDI and Golkar as well, in reality it is Golkar that is capable of exploiting that relationship to reach the masses up to the village level. Moreover, Golkar's internal dynamics reflects for its greater part, the influence of the suprastructure of the process of national politics. As to this last statement, see Awad Bahasoan, "Golong-an Karya: Mencari Format Politik Baru" in *Prisma* No. 12 (December 1981), pp. 44-67. Golkar's much better position was made possible since its outset. Golkar was considered to be the alternative of a renovation group which along with the Military constitute the prime supporters of the new political format taking stability and organised renovations which are developed by Soeharto as a frame of reference. For this, see Alfian, *Pemikiran dan Perubahan*, esp. pp. 29-58; see also Julian M. Boileau, *Golkar: Functional Group Politics in Indonesia* (Jakarta: CSIS, 1983), pp. 45-58. In such a situation one can understand that the desired political format could only be achieved by leaving Golkar to co-operate with the bureaucracy -- which notabene constitutes the government's official right hand in discharging its duties -- on the one hand, and on the other, to alienate parties from the bureaucracy. In turn, the factual tendencies as described above is certainly producing a party structure which is "unjust" at least for the parties of PPP and PDI. See for instance, Drs. Mardinsyah, "Beberapa Catatan tentang Pemilu 1987." Paper presented at the Seminar on the 1987 General Election, PPW-LIPI, 6 June 1987; see also Dr. Suko Waluyo, "Catatan Lcpas Pcmilu 1987," paper at the same seminar.



bodies of PPP and PDI are apparently closely related to the two problems already mentioned.

### Scarcity of Positions and Resources

From the above explanations it may be seen that the Soeharto government has a basic perception that political parties constitute the source of conflicts and political instability as experienced during the Liberal Democracy period. Either a government run party or parties engaged with the government bureaucracy are regarded as "past bad experience" which should not be repeated.<sup>24</sup> The creation of a "distance" between party and bureaucracy seems to indicate that tendency. Besides, party involvement in the bureaucracy will disturb and even hamper the bureaucratic task in rendering services, more so in an era of development which always has been the government's obsession. People are convinced that the task of the bureaucracy as the implementor of policies can only be discharged smoothly if it is kept at a distance from politics, including its collaboration with political parties.

The implementation of this position is that any opportunity for party politicians to sit or to occupy a position in the government's bureaucracy is ruled out, particularly as a cabinet minister's position which con-

stitutes an elite in the bureaucracy. It is therefore not surprising that during the New Order administration, except for HMS Mintaredja and Frans Seda, not a single party exponent, or politicians has been appointed as minister in the development cabinet. The Position of the Minister of Religious Affairs, the last only hope for PPP -- because it constituted previously a "quota" for the Islamic party -- has been occupied consecutively by non-party prominents since the 2nd Development Cabinet (1973-1978): Mukti Ali, Alamsjah Ratuperwiranegara and Munawir Sjadzali. Hence the only government positions open for party politicians are in the legislative institutions. Party circles are well aware of this limitation, so the struggle of parties or groups within parties is only confined to scoring seats in the House of Representatives.<sup>25</sup>

Apart from that limitation, parties are facing at least two other realities. First, positions (seats) in the House of Representatives obtainable by those from party circles are increasingly diminishing, while the number of seats obtained by the "government faction" (F-KP and F-ABRI) are increasing. After the 1977 general election, the balance of power between the party factions of (F-PDI) and "government faction" was 128 seats (27.83 per cent) against 332 seats (72.19 per cent); after the 1987 General Election, the balance changed to 101 seats (20.20 per cent) against 399 seats (79.80 per cent).<sup>26</sup> The opportunity to obtain seats when the small number available is increasingly becoming smaller would

<sup>24</sup>Probably, in this context also one could understand why Golkar refused to be called, or to call themselves a "Political Party" although party circles have admitted that Golkar functionally is in fact a political party. Sarwono Kusumaatmadja, former Secretary General of Golkar, for instance, stated, "Golkar is not less than its name is. It is Golkar's right to retain its name." Interview, at the end of 1987 at Golkar's headquarters at Slipi, Jakarta.

<sup>25</sup>Also see, Sjamsuddin Haris, "PPP dari Aneol ke DPR" in *Pelita*, October 11 1986.

<sup>26</sup>See, Djohermansyah Djohan, "Pola dan Masa Depan Perimbangan Kekuatan Politik di DPR," paper presented at the Seminar and 1st National Congress of AIPI, December 7-9 1987, see the table p. 11.



certainly exacerbate already existing differences within the parties, which will lead to conflicts.

Secondly, the process of leadership transfer within those two parties is at a standstill, while there are more people wanting to obtain leadership positions PPP constitutes a classic example. During 11 years of this party's existence, it managed to convene only one congress despite the party's statutes/bylaws which stipulate that congresses should be held once in four years. The party's leadership always had an excuse for postponing a congress that has stimulated the development of conflicts among itself.

PDI has staged three congresses; however, as is the case with PPP, it also has postponed holding a congress, particularly on the eve of the 1981 congress and that of 1986. If the party statutes were used as reference material, the second congress should have been held before 1981 (considering that the first congress was held in 1976) while the 3rd congress should have been held four years later. Various efforts made by the former leadership in postponing the congress coloured the party's behaviour on the eve of both the second as well as the last congress. During the third congress, for instance, the PDI leadership led by Sunawar Sukowati clearly wanted a national convention of the *Majelis Permusyawaratan Partai* -- the second highest institution below the Congress-held-before the start of the third congress, in order not to disturb the general election. This move naturally was opposed by a group led by Hardjantho, who wanted the congress be held before the general election.<sup>27</sup> This difference of opinion further developed into a conflict resulting in PDI's failure to elect a

formateur to compose a new leadership.

One can see that within the leadership a fierce rivalry existed, with one group maintaining the status quo and another group wanting a change of leadership in compliance with party statutes. For the two parties, the position of party leadership is a short cut to obtaining a position in a legislative institution, especially in the House of Representatives.

Conflicts within PPP concerning the "struggle" in 1980 for the seat of Chairman of Commission VII in the House of Representatives (DPR) between exponents of NU and MI (*Muslimin Indonesia*), the case of (PPP's list of candidates) for the 1982 General Election at the end of 1981 between the two similar exponents, and the conflict between the group of J. Naro and Soedardji concerning the change of the F-PP leadership in the House of Representatives, can be seen as being an aspect of this view. This is also the case with the 1987 conflict within PDI between Sanusi/Usep and Isnaeni/Sunawar on the eve of the congress, as well as the 1987 conflict between Kemas Fachrudin et.al. and the leadership (see Appendix).

## Political Alienation

One interesting aspect of the 1973 party fusion was that the merger of nine parties into two "new" parties was motivated by the outside factors of government pressure as well as national political change, rather than by those from within the respective parties. This has caused a low degree of integration among elements of the existing ex-parties. Although the four fused elements within PPP are from ex Islam parties, it does not follow that either their religious or political

<sup>27</sup>*Tempo*, January 18 1986.



perceptions are common. This case also applies to PDI. The differences within this party are so sharp that since its outset the five merged elements have an innate source of conflict.

Because party circles are well aware of this unfortunate position, some of them have taken an "accommodative" stance in their political behaviour,<sup>28</sup> while other circles try to show their "radical" posture in a bid to maintain their historical pride as party activists. However, as has been proven, politicians who have chosen this behavioural pattern are generally pushed aside from the New Order political stage. Cases of conflicts either within PSI or PPP may be seen as coming from tensions as well as collisions between "accommodative" party leaders and "radicals."

Although those accommodative politicians can survive and are strong enough, this does not mean that they can anticipate immediately the course and tendency of national politics. This is due at least to three factors. First, party politicians are not involved, or made to be involved, in the reordering of political life. Although parties and party politicians have been formally acknowledged, they are not part of the elite circle of decision makers.<sup>29</sup> This can be observed in

general in the process of making law and particularly in the field of politics.<sup>30</sup>

Second, the development of the party system is uncertain. The scope of party movement is restricted, either formally by virtue of law in force, or informally through institutions of *restu* (blessing), clearance, and the like with regard to the selection of party leaders. However, parties are requested and persuaded to be more independent and to be more active in their participation in development. The parties are recognised formally as having an equal position to that of the *Golongan Karya*, but do not enjoy equal freedom in collaborating with the bureaucracy.

This dilemma conceptually leads to the question of what kind of party needs to be further developed. The system pursued is still of a multi party character due to the numbers involved; however, the system is proceeding towards "a dominant party system" in which *Golkar* appears as the hegemonic party.<sup>31</sup>

Third, there is a low degree of sensitivity of the party elite with regard to current political changes. This seems to have its

<sup>28</sup>See, Fachri Ali and Iqbal Abdurrauf Saimina, "Merosotnya Aliran dalam Partai Persatuan Pembangunan" in *Prisma*, No. 12 (December 1981), pp. 24-43; see also Kaisiepo, "Dilema Partai Demokrasi Indonesia." For the posture of inside PDI, see also Marcellianus Djadijono, "Strategi dan Taktik PDI dalam Mempertahankan Eksistensinya sebagai Kekuatan Sosial Politik di Indonesia." Thesis as a partial fulfilment to obtain a Sarjana degree at the FIP-Unas, 1985.

<sup>29</sup>For the concept of "Circle of Decision" see Suzanne Keller, *Penguasa dan Kelompok Elit*, translation by Zahara D. Noer (Jakarta: Rajawali, 1984).

<sup>30</sup>Concepts of law or bills which generally originate from the government certainly constitute the product of the bureaucracy. Parties are indeed given the opportunity to contribute their opinions or to make amendments in the House of Representatives, at the time the bill was being discussed. However, in general there are no fundamental changes if the bill was passed into law. See for instance, Arbi Sanit, *Perwakilan Politik di Indonesia* (Jakarta: Rajawali, 1984).

<sup>31</sup>As to such party concept, see Duverger, *Partai-partai Politik dan Kelompok-kelompok Kepentingan*, 1st ed., translated by Laila Hasyim (Jakarta: Bina Aksara, 1981), p. 40. For interesting discussion concerning the New Order party system, see, Daniel Dhakidae, "Partai Politik dan Sistem Kepartaian di Indonesia" in *Prisma*, No. 2 (December 1981), pp. 3-23.



source in the diminishing numbers of intellectuals and thinkers pursuing careers as party politicians. This is normal, considering that attacks made against parties at the onset of the New Order came partly from intellectual circles, particularly from those who joined the KASI (*Kesatuan Aksi Sarjana Indonesia* - the Joint Action of Indonesian Academics).<sup>32</sup>

These factors made party politicians dependent on outside power (especially from the government) so that every political behaviour came to the fore within the context of obtaining legitimacy from the owner of that power. The conflict which touched upon the issue of "party modernisation" launched by Ridwan Saidi who later was not on friendly terms with J. Naro, and the conflict within PPP concerning the party's symbol of *Ka'bah* (1984) between the group of Soedardji/Syarifuddin Harahap/BT Achda versus J. Naro which lasted for almost seven months may be perceived as part of this tendency. Likewise, the difference of opinions on the eve of PDI's second congress in 1981 between Sunawar/Isnaeni versus "The Group of Four" (Usep Ranawidjaja, Abdul Madjid, Mrs. D. Walandouw and Zakaria Raib) and the conflict concerning the issue on "secular State," spread among the Sunawar Sukowati faction on the one hand and that of Hardjantho on the other in 1984 (see Appendix).

In addition to the leadership issue, another important source of conflicts of a convention or congress has been efforts made by respective rival groups to gain the government's sympathy with the hope that the

government will support one of them and make it win. This tendency may be observed from the dissemination of statements by the parties in conflict to the media before issuing them in the formal party's forum. If the government did not side with one group the conflict tended to last for a long time. This also applies conversely and can be observed especially in the case of PDI. At the time the government had chosen Soerjadi as the general chairman of the new executive council<sup>33</sup> and the conflict appeared to have ended, but the mentioned choice was meant only to muffle the existing conflict.

All these reflect the alienation of political parties and party politicians. The conflicting parties, PPP<sup>34</sup> or PDI, attempted to either translate or interpret the course and tendency of the government. For instance, it was to what extent the government allowed the use of the *Ka'bah* symbol in the 1987 General Election that Soedardji et.al. attempted to forward as an issue to defeat Naro. Even though the *Ka'bah* symbol later was no longer regarded as being in line with the spirit of the 1983 Guidelines of State Policy, J. Naro still survived. This is a real illustration that the "defeated" party has reached an enquiry and seeing stage to the extent that Naro is tolerated by the possessor of power to retain his position.

<sup>33</sup>The Third PDI Congress failed in electing a formateur to compose a new executive council. Eventually it was decided by the government to appoint Soerjadi as formateur. See *Tempo*, April 19 1986.

<sup>34</sup>Another form of PPP's political alienation can be seen during the 1987 General Election. On the one hand PPP's campaigner admitted that the party is based on Pancasila, but on the other, it still claimed to be the only accommodation for Islamic politics. See, Syamsuddin Haris, "PPP, Asas Pancasila dan Penggembosan dalam Pemilu 1987," in *Ilmu dan Budaya*, No. 4 (January 1980), pp. 303-316.

<sup>32</sup>It was among others voiced by Adnan Buyung Nasution and Mochtar Lubis. See, Samsuddin et.al., *Seri Berita*, p. 5.



## Political Ideology

Political ideology teaches, drives and controls individuals, groups and the nation's political behaviour and actions.<sup>35</sup> Political ideology here refers to group behaviour and actions, particularly in ideological groupings such as parties.<sup>36</sup> An unavoidable general trend is that with greater differences of political ideology in such a grouping, the potential for fiercer conflicts is greater.

Existing differences within PPP and PDI make up an inseparable part of the characteristic of the fusion. Those differences have become the characteristic and identity of the respective ex-parties and will remain despite the fusion of those elements. This reality will generate inevitably into a difference of outlook and evaluation, either with regard to the course on which the current political reform proceeds, or to the execution of the New Order government's authority.

This may be seen in the conflict within PPP at the onset on 1980, begun by the absence of the PPP Faction originating from NU elements at the plenary session for the passing into law of the bill on the House of Representatives general election. In this case, politics for NU is essentially part of the interpretation of a worldly stance towards religion. Therefore, as contended by Zamakhshari Dhofier, NU's political goal can be found in the aim of its religious thoughts, and his organisation's political ideals can only be conceived as being a part of the religious ideals.<sup>37</sup> Within this context, NU sees

as a principal question what is fought through the bill on the general election, particularly regarding the presence of a representative of political organisations in the Election Committee (KPPS).

Unlike the NU view, the MI (*Muslimin Indonesia*) Group sees politics as being realistic, related to neither ideology, the masses, nor religious commitment as the basis of the struggle.<sup>38</sup> Perhaps this view stems from the reality that MI has no clear cultural base, unlike NU. For MI, the government is only a legitimate source so it is also not surprising that PPP's accommodative behaviour stems in general from this group.

In this light, NU's action during the plenary session on the passing into law of the general election as mentioned above may be understood. It follows that this stance may be seen as NU adhering to its political ideological relation; namely that the general election could be held in a direct, general, free and secret manner if political organisations could be involved, in at least the general election committee. That this sort of political ideology did not sufficiently emerge afterward, or was not further brought out in the behaviour of this group, indicated how strong the de-ideological stream proceeded in the process of political reform launched by the New Order government. In light of this perception, NU also became accommodative gradually, after the 1982 General Election, in a posture contradictory to its previous stance.<sup>39</sup> In its further development

<sup>35</sup>Christenson et.al., *Ideologies and Modern Politics*, p. 3.

<sup>36</sup>The Party as "Ideological Group" taken from Duverger, *Sosiologi Politik*, p. 267.

<sup>37</sup>Zamakhshari Dhofier, *Tradisi Pesantren: Studi tentang Pandangan Hidup Kiyai* (Jakarta: LP3ES, 1980), p. 170.

<sup>38</sup>See Soetardji's view in *Tempo*, October 3 1981. See also Syamsuddin Haris, "Konflik NU-MI dalam PPP," p. 84.

<sup>39</sup>NU's phenomenon of "Radicalism" in its political posture emerged during the decade of the 1970s, reminiscent to that of Masyumi in the 1950s. This, for in-



NU even became the first largest mass organisation declared ready to acknowledge Pancasila as the sole principle in the Situbondo Convention of NU's Islamic Scholars at the end of 1983.

Being a fusion of ex-parties which differ so much, PDI has a much greater potential for conflict in terms of political ideology. Nevertheless, since the PNI element is so great in number<sup>40</sup> compared to the other four, the conflict is rather a "routine" phenomenon for this element. It may be noted that conflicts which occur hardly exist between elements within the party. One conflict that may be regarded as a rift of elements is the conflict between Achmad Sukarmawidjaja et.al. versus Sanusi Hardjadinata et.al. This conflict was actually a polarisation between IPKI/Murba versus PNI supported by *Partai Katholik* and *Parkindo* (see Appendix). The only conflict having its source in the political ideology was that between Nico Daryanto/Soerjadi and "the Group of 17."<sup>41</sup>

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stance was observed by Mitsuo Nakamura during the Semarang Convention (1979). See, Nakamura, *Agama dan Perubahan Politik: Tradisionalisme Radikal NU di Indonesia* (Surakarta: Hapsara, 1982).

<sup>40</sup>During the 1955 General Election PNI scored 22.3 per cent votes while the other four elements in PDI only scored 6.5 per cent. See, Alfian, *Hasil Pemilihan Umum 1955 untuk Dewan Perwakilan Rakyat* (Jakarta: Leknas-LIPI 1971), Table II, p. 9, however in the 1971 General Election PNI's score dwindled drastically and became 6.9 per cent, while the total score of Parkindo, Partai Katolik, IPKI and Murba was 3.1 per cent. See, Samsuddin, et.al., *Seri Berita*, Table IV, pp. 154-155.

<sup>41</sup>This conflict started with the emergence of Nico Daryanto, Secretary General of PDI's Executive Council and Chairman of F-PDI in the MPR concept, who proposed the abolishment of religious education at formal schools. Although that proposal was rejected by MPR's daily executive committee, mentioned concept was rejected by 17 members of F-PDI themselves. See,

Differing views about the place of religion in education seem to have their source in differing interpretations of the two conflicting groups concerning the tendency of the national political engineering after Pancasila was enacted. For Nico Daryanto, with the enactment of Pancasila as the sole principle, it implicitly follows that religion has become a personal matter; therefore, there is no longer a need to include religion in the compulsory curriculum of formal schools. "The Group of 17" has regarded this view as being "too advanced," perhaps putting in jeopardy the government's development of national unity and integrity, as it relates to the sensitive problem of religion.<sup>42</sup> Despite other problems accompanying the widening of the difference of opinions between the two groups -- which was one result of the conflict on the eve of the third congress -- the proposal to submit to the executive body of the People's Consultative Assembly revealed a relatively basic disagreement within PDI. With this difference of opinion, the differing views on the relationship between religion and politics and the differing interpretations about the enforcement of the sole principle, may be seen as the sources of conflict between the two groups. Accordingly, the difference of views with regard to the essence of power and the execution of power -- in this case, the political engineering by the New Order government -- will bring about incompatible political behaviour which will lead to a conflict.

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*Tempo*, 5 December 1987. With regard to the conflict of both parties, see also, *Masalah dan Prospek Organisasi Politik Peserta Pemilu Setelah Pemilu 1987* (Stage III Project Report of the 1987 General Election), the Political and Regional R & D Centre in Co-operation with the Socio-political Directorate General of the Department of Home Affairs of the Republic of Indonesia.

<sup>42</sup>*Ibid.*



## The Intensity of Conflicts

The above elaboration is interesting because the position of the unfortunate party has produced a two-party dependence on the course of the current political reform. However, this development has weakened further the party's position in its relation with the government. This weakening means that the pattern of the party's posture and activities must be adjusted to the demand of the "new political culture" with political stability as a base for improving the economic environment. Alfian identified this desired new behavioural pattern as "rational persuasive," referring to the disliked one as "emotional confrontative."<sup>43</sup>

The implication of these desires and demands that the spirit and the posture, which are inclined to be radical within party organisations, must be substituted with a more accommodative posture able to accept the new demand. Within this context the conflicts within PPP and PDI constitute a typological shift of leadership within the two parties, from a leadership with a disfavoured behaviour to a party leadership adjustable to the new demand.<sup>44</sup> In this respect, one may understand the phenomenon of government interference in the conflicts of either PPP or PDI, that is, in its effort to eliminate the resurgence of the old behavioural pattern in party life.

It is not surprising that the intensity of conflicts within the two parties depends on whether or not there is government in-

<sup>43</sup>An emotionally confrontative posture which tends to sway towards the bringing into a conflict of school of thoughts and ideology of a group and claims to be the rightful one. See, Alfian, *Pemikiran dan Perubahan Politik*, pp. 89-92.

<sup>44</sup>Compare, Fachry Aly and Iqbal AS, "Merosotnya Aliran," pp. 37-41.

terference. The sooner and the more the interference, the sooner the conflict within the party subsides, although government interference later produces new seeds of conflict. In the struggle between NU and MI within PPP, for the position of the Seventh Commission Chairman in the House of Representatives, the conflict was solved after F-KP and F-ABRI supported Soedardji's ambition to seize the position by ushering him to win during the plenary session for the re-election of commission chairman. Similarly, the conflict around the new third PDI's congress was solved only after the Minister of Home Affairs, Soepardjo Rustam, appointed a formateur to form a new executive council. In addition, the 1978 conflict between Sanusi Hardjadinata and Isnaeni/Sunawar Sukowati was solved by BAKIN, and the conflict between Hardjantho and Usep Ranawidjaja was peacefully solved by *Kopkamtib* (The Command for the Restoration of Security and Order) in the same year (see Appendix).

When the government tends to keep "silent," the conflict within parties tends to protract. Examples include the conflict between Idham Chalid and J. Naro within PPP concerning the formation of a convention committee, and the conflict between Soedardji et.al. and J. Naro concerning the party symbol, which lasted from the end of 1984 to July 1985. These two conflicts were solved only after Naro was supported instead of the other groups; however, in the case of the party symbol, only the view of the Soedardji group was accepted, where the Ka'bah was substituted with another symbol.

## Pattern of Trends

Compared to party conflicts in the past, particularly during the Liberal Democracy



period, conflicts during the New Order period show different trends and patterns. The differences are noticeable in the government's direct or indirect involvement in the PPP and PDI's conflicts. During the previous periods, parties often were in conflict to obtain a government position. After the 1973 fusion, the government -- particularly in its dominant role as in deciding the course for national political reform -- tends to become the factor behind the development of a conflict, so that it often influences the intensity of the conflict. In addition, the difference in pattern is reflected in the form of the conflicts that arise. If in the past conflicts occurred either within parties, and even involved the masses, during the period being studied conflicts are being localised to become internal ones within the parties.

This last trend was caused by several factors. First, the party system during the Liberal Democracy period was relatively open, while so far, the party system as developed by the New Order tends to be a closed one. For instance, when K.H.A. Wahid Hasjim in 1952 could form the NU Party after having been disappointed and quitted the Masyumi, what could K.H. Jusuf Hasjim and Mahbub Djunaidi do after being disappointed and quitting PPP?<sup>45</sup>

Another factor was the different position in the political set up in force. As noted, if in the past parties got opportunities to gain leverage by snatching a position within the

government, parties today are not able to obtain those opportunities. Another implication of this factor is the fundamental change of the parties, posture from one that possessed "power" to one which is solely a "provider of legitimacy," at least in the sense of taking part in retaining the status quo of power.

A third factor was the decline of ideology and the school of thoughts as the basis of the party's struggle during the New Order. The party's struggle for an alternative ideology and school of thoughts was an inseparable part of past party conflicts, which do not exist any longer.

These three factors have in turn generated tendencies within the party conflicts in this period. Conflicts that emerge tend to have their source in an individual or group's interest rather than in the party's or societal interest, which is regarded as being represented by a party. Almost all PPP and PDI's conflicts during the last ten years were centred only on the problem of position and function, either in the legislative body or in the party leadership. The momentum of conflicts -- which nearly always occur on the eve of a general election or the holding of a convention or congress -- indicate those tendencies. In consequence, almost all existing conflicts were related to unprincipal matters which did not touch upon fundamental problems, such as alternative thoughts related to problems faced by the nation. Therefore it is not surprising that in a forum such as in DPR, the government faction (F-KP and F-ABRI) are sometimes more vocal than the F-PP and F-PDI.<sup>46</sup> Such conflicts generally

<sup>45</sup>Although NU through its 1984 Situbondo Convention has decided to return to the 1926 *khittah* (Prowess) which means to sever from its political activities, the political wing of NU however, such as Mahbub Djunaidi and Jusuf Hasjim, want in fact the organisation still to be involved in politics. Mahbub, if permitted, wanted to form a new party besides the three existing political organisations. See, column writings of Mahbub in *Tempo*, November 7 1987.

<sup>46</sup>Sarwono Kusumaatmadja, Golkar's Secretary General even stated that "PPP is more Golkar than the Golkar itself." See, *Pandji Masyarakat*, No. 537 (21-30 April 1987): p. 18.



do not have a final solution. This means that whenever any party conflict subsides, the remnants constitute the seeds which will later produce new conflicts. This is apparently connected with the government's dominating factor in the conflicts as already noted. On the other hand, government involvement seems to depend on how capable the parties are to maintain a low profile, in the sense that they are capable of eliminating the

growth of "radicalism" and the "old political behaviour" in the parties. In other words, conflicts seem still to be part of PPP and PDI's party life as long as the two parties cannot anticipate the direction of the national and political tendencies. Especially after the enactment of Pancasila as the sole principle, the conflict pattern seems to have shifted from the conflict of elements and groups to conflicts of an individual nature.

#### Appendix I

#### PPP'S CONFLICT CHART

No.	Case	Parties in Conflict	Conflict Material	Conflict Source and Its Nature
1.	NU's rejection of the 1980 General Election bill ratification.	NU vs Non-NU	NU opined that the General Election can not be general, free & secret as long as parties are not involved in its committees, at least as supervisor at the polling stations. MI & two other exponents (SI & Perti) could accept the general election bill to be ratified.	Political ideology. Semi fundamental.
2.	"Expression of concern" by 50 prominent society's leaders submitted to DPR (Petition of 50) (1980).	NU-MI (Muslimin Indonesia)	Rachmat Muljomiseno & Muddin Lubis (NU) "Supported and could comprehend mentioned statement by the 50 society leaders concerning Presidential speech off the cuff in Riau & Cijantung (Jakarta) on ABRI's task which is very important during the New Order. MI as announced by Soedardji criticised mentioned statement.	Idem
3.	"Vying" for the position of Chairman of the 7th Commission in DPR (1980)	NU-MI	NU and MI respectively desired to occupy the position of the 7th Commission. Before 1979 MI	Scarcity of positions and source. Not fundamental.



No.	Case	Parties in Conflict	Conflict Material	Conflict Source and Its Nature
			challenged the position of the 7th Commission and was willing to exchange for the chairmanship of the 8th commission & Deputy chairman of the commission on the state budget so far held. This was agreed and was granted the following year. In 1980 NU demanded the return of mentioned position but was rejected by MI.	
4.	Submittance of PPP's provisional list of candidates (DCS) for the 1982 (1981/1982) General Election.	NU-MI	PPP's general chairmen, J. Naro submitted PPP's DCS for the 1982 General Election without the knowledge of the other executive members, especially among NU circles. NU rejected mentioned DCS, particularly concerning the balance of seats in it. NU protested to the General Election Institute (LPU) but was rejected.	Scarcity of positions and sources. Not fundamental.
5.	NU's posture in demanding J. Naro to uphold the principle of consultations ( <i>Musyawah</i> ) in the party (1983)	Idham Chalid/ Saifudin Zuhri/ Imam Sofwan vs J. Naro	J. Naro altered the composition of the leadership (DPP) without the knowledge of the Party's President, Idham Chalid and other DPP members.	Scarcity of positions and source. Not fundamental.
6.	The forming of the 1st Convention (1984)	Idham Chalid vs J. Naro	J. Naro formed the Convention Committee with Darussamin as chairman without the knowledge of the party's President. Idham Chalid and was therefore regarded as null and void. Idham then formed a rival committee with Dahrif Nasution as chairman.	Idem.
7.	Discussion on Article 18 of the Bill on the General Election concerning parties symbols (1984-1985)	Soedardji/Syarifudin Harahap/BT Achda vs J. Naro	Soedardji's group opined that since PPP had adopted the sole principle, the symbol of the Ka'bah which is indicative of Islam should be replaced. Naro said that the symbol was agreed upon at the convention.	Political alienation. Not fundamental.



No.	Case	Parties in Conflict	Conflict Material	Conflict Source and Its Nature
8.	Failure to oust J. Naro on the issue of the party symbol (1985)	"The Group of 18" (Soedardji et.al.) vs J. Naro	Soedardji formed his power of 18 men. This group of 18 later formed a shadow Executive Council with Syah Manaf as the General Chairman and Syarifudin Harahap as General Secretary.	Scarcity of position and sources. Not fundamental.
9.	There was twice a change in the leadership of the F-PP faction at the DPR beyond the knowledge of the 1985 Executive Council.	Soedardji et.al. vs J. Naro	To strengthen his group, Soedardji made alterations in the composition of the F-PP's leadership unilaterally. Those who were ousted (Imam Sofwan, Nuhassan Ibnu Hajar, Lukman Hakim, Djaffar Siddiq) with Naro's backing formed a rival F-PP having its office at the Executive Council's office.	Idem.
10.	The issue on the "Party modernisation" by Ridwan Saidi.	Ridwan Saidi vs J. Naro	Ridwan opined that the "Islam formula" in PPP should be abandoned if PPP accepted Pancasila as the sole principle. Naro protested against it.	Political alienation. Not fundamental.
11.	Submission of PPP's 1987 General Election's List of Provisional Candidates.	Soedardji et.al. vs J. Naro	Naro submitted PPP's DCS for the 1987 General Election by deleting Soedardji's group from the list. Soedardji drew another list but was rejected by the Home Minister.	Scarcity of positions and sources. Not fundamental.
12.	Letter from the N. Sumatran regional branch (DPW) informing that Mardinsyah's father in law the Secretary General of the branch, was "PKI oriented"	Soedardji et.al. vs Mardinsyah/J. Naro	Soedardji concluded that Mardinsyah "must also be PKI oriented." Therefore Soedardji as F-PP's chairman later recalled Mardinsyah from DPR's membership.	Idem.

*Source:* Data on the 1980-1982 conflict was taken from Fachry Ali and Iqbal Abdurrauf Saimima, "Merosotnya Aliran" and Syamsuddin Haris, "Konflik NU-MI dalam PPP." The 1983-1985 data on the conflict was taken from Juanda's "Konflik dalam PPP 1984-1985" thesis submitted to FIP-UNAS, 1986. Data of 1986 were taken from *Tempo*, 30 August 1986, 4 and 11 October 1986.



Appendix II

PDI'S CONFLICT CHART

No.	Case	Conflicting Parties	Conflict Material	Source and Nature of Conflict
1.	Mh. Isnaeni & Sunawar Sukowati discharged from General Chairmanship & PDI's chairmanship (1975)	Isnaeni/Sunawar vs Sanusi Hardjadinata/Usep Ranawidjaja	Isnaeni/Sunawar not in favour of the immediate holding of 1st Congress, considering fusion was made recently. Isnaeni/Sunawar not present at DPP's meeting to discuss the issue.	Scarcity of positions and source. Not fundamental.
2.	1st Congress (1976)	Sanusi/Usep vs Isnaeni/Sunawar	Influencing one another prior to DPD's congress. Dualism in leadership due to former conflict.	Idem.
3.	F-PDI's quota for seats of DPR/MPR's Deputy Chairmen (1977)	Achmad Sukarmawidjaja/Muhidin Nasution et.al. vs Sanusi/Usep (IPKI/Murba vs PNI supported by Parkindo & Catholic Party)	Debates on the presidential candidate. Isnaeni elected as Dy Chairman of DPR/MPR by the support of F-KP and F-ABRI. Achmad et.al. thereafter restructured DPP. Sanusi/Usep replaced resp. by Isnaeni/Sunawar, each as Gen. Chairman & Chairman.	Scarcity of positions & Source/Political alienation. Not fundamental.
4.	New DPP composition after conflict settled by BAKIN (1978)	Sanusi Hardjadinata vs Isnaeni/Sunawar	Isnaeni/Sunawar discharged from DPP as they were considered creating unrest in PDI. Isnaeni/Sunawar as PNI's mandatary retaliated by discharging Sanusi as DPP's general chairman.	Scarcity in positions & source. Not fundamental.
5.	Usep discharged by Hardjantho Sumodisastro and Sabam Sirait (Chairman and Secretary General from his DPP's Chairmanship, 1978)	Hardjantho Sumodisastro vs Usep Ranawidjaja	Aftermath of previous conflict (Hardjantho at.al. considered Usep exacerbating conflict in PDI)	Idem.
6.	Pre-2nd Congress (1981)	Isnaeni/Sunawar vs "The Group of 4" (Usep, Abdul Madjid, Mrs. D. Walandouw, Zakaria Raib).	"The Group of 4" disputed the legitimacy of the congress since the representatives were not elected by the branches congresses. Isnaeni/Sunawar opined that a Congress could reduce PDI's conflict.	Political alienation/scarcity of positions & source. Not fundamental.



No.	Case	Conflicting Parties	Conflict Material	Source and Nature of Conflict
7.	Post 2nd Congress "The Group of 4" recalled (1981)	Result of 2nd Congress: DPP's General Chairman, Sanusi Hardjadinata vs "The Group of 4"	"The Group of 4" defied 2nd Congress result and questioned DPP's authority in recalling them from DPR.	Scarcity in positions and source. Not fundamental.
8.	DPP's Chairman, Sunawar's statement that Indonesia is a secular state (1984)	Hardjantho vs Sunawar	Hardjantho defied Sunawar's statement that Indonesia was a secular state which he regarded as contrary to the principles in the 1945 Constitution. Hardjantho tried to discharge Sunawar on the eve of 3rd Congress.	Political alienation/ Scarcity of positions & source. Not fundamental.
9.	Third Congress	Sunawar et.al. vs Hardjantho	Sunawar (General Chairman) wanted the congress to be held after General Election. Hardjantho wanted before it.	Scarcity in positions and source. Not fundamental.
10.	PDI DPP's demand that Kemas Fachruddin, J.C. Palaoensuka and Achmad Subagio abide by DPP's Decision No. 059/1986 on the maximum terms of duty for F-PDI membership in DPR (1987)	Soerjadi/Nico Daryanto vs Kemas et.al.	Kemas et.al. desired to remain in DPR since they were elected in their resp. constituencies. Meanwhile DPP considered that they should abide by DPP's decision despite their election in their constituencies.	Idem.
11.	Nico Daryanto's (F-PDI's chairman) concept on religious education at formal schools (1987/1988)	Nico/Soerjadi vs "The Group of 17"	17 members of F-PDI at MPR rejected Nico's concept on the abolishment of religious education at formal schools as it jeopardise national unity & integrity.	Political ideology. Semi fundamental.

*Source:* Data on conflict were taken from Kaisiepo's, "Dilema Partai Demokrasi Indonesia," Djadijono, "Strategi dan Taktik PDI" and "Masalah dan Prospek Organisasi Politik."



# Australia and Its Strategic Position in the Asia-Pacific Region

Michael O'CONNOR

## Introduction

**A**T THE FIFTH Australia-Indonesia Conference held at the Australian National University during May 25-27, 1989, Ambassador Hasnan Habib attracted some attention from the Australian press for a paper which hinted that some in Indonesia saw Australia as a potential aggressor in Southeast Asia.

This view suggested that those circles in Indonesia, as well as many in Australia, have an imperfect understanding of the basic strategic imperatives upon which Australia must construct a security policy. This article is designed to contribute to a greater understanding of Australia's unique position.

It is perhaps useful to open with a small offering from the celebrated British author of the early twentieth century, G.K. Chesterton who put into the mouth of his famous detective, Father Brown: *It isn't that they can't see the solution, It is that they can't see the problem.*

As with any specialised subject, be it national security or industrial relations, or anything else, the practitioners have a jargon of their own which is usually very tightly defined and just about incomprehensible to outside. That, of course, is deliberate.

So, in national security terms, the "experts" tend to talk about national strategy, grand strategy, strategic position and military strategy. They all mean different things. The Oxford English Dictionary describes strategy as *the art of so moving or disposing troops or ships or aircraft as to impose upon the enemy the place and time and conditions for fighting preferred by oneself*. That is actually definition of military strategy but the general point is valid. Strategy in almost any other field would have essentially the same definitions; only the tools would be different.

Strategic position then, especially as it relates to Australia, would seem to mean something like the strategy which is derived from a consideration of position. of what we are, where we are and so on, those elements of strategy that are constant because they are impossible or difficult to change.



It is important to recognise in this context that any strategy will have limits or may have unintended consequences if the constants which make up strategic position are not taken into account. The following is a case in point.

One of the basic assumptions of those Australian planners who favour an isolationist defence strategy is that this country should deploy a large proportion of her military power in the north, at or near Darwin. That was policy back in 1938 and it was revived with the publication of the 1986 Dibb Report and the 1987 Defence White Paper.

But one of the enduring realities of Australia's strategic position is that Darwin is of considerable strategic significance on a regional and, indeed, a global basis. A look at the map will show that Darwin lies on the flank of the principal junction between the Indian and Pacific Oceans, through which passes a very large and growing proportion of the trade of the world. Indeed, given the assumption that the next century will be the Pacific century, those waterways are likely to become even more important than they are now.

So if, for reasons of sheer preservation or an unduly modest or ill-informed view of its strategic importance, an Australian government then deploys military power around Darwin, it has, whether intentionally or not, changed both the regional and global balance of power. Of course, in doing that, there may well be unintended consequences. It may attract unwelcome attention (as it did in 1942-1943) and invite the very attack the government originally sought to deter. Alternatively, it may cause analysts in the neighbourhood to wonder at Australia's expressed peaceful intentions.

## Sources of Strategic Position

### *Geography*

The most basic source of Australia's strategic position -- or any country's for that matter -- is its geography.

Aspects of geography such as global position, size, population, terrain and resources are all central to the question of strategic position because they are the basic characteristics of that country. More than any other factor, they cannot be changed in the short or medium term, if at all.

Of course, some of these realities lead to conflicting choices. Australia's population is largely centred in the southeast, suggesting that its principal defence efforts should be directed at that part of the country. On the other hand, much of its wealth is derived from mineral resources in underpopulated and remote parts of the north. So, there is a need to pay attention to their security.

Even in this relatively simple choice, the answer, whichever it is, will lead to very different conclusions about military forces, capabilities, strategies and expenditures.

There is another basic strategic question to be asked about any country. Is it a maritime or a continental power? This question is asked in the context of what is known as geopolitics.

Geopolitics sees the world as a collection of continental or maritime nations according to their position in relation to the world Heartland which is what is now known as the Soviet Union and, to a lesser extent, China. Continental nations are those which generally interact with each other on land and which do not need to cross the seas to trade or otherwise communicate.



By contrast, maritime nations are those which must use the sea for trade and other intercourse.

By this definition, Australia, although it is a continent, is a maritime nation and its strategy should be a maritime strategy. In this there is no real choice because, large as Australia is, its people can only relate with the rest of the world by or across the sea. In fact, most strategic debates in Australia since the Federation in 1901 has been about this very point although it has rarely, if ever, been expressed in such fundamental terms.

An interesting example these days of a nation with the choice is India. India has for centuries been a continental power. Indeed, it was because India was not a maritime power that it lost its independence to the Europeans some centuries ago. Since independence in 1948, India has been primarily a continental power focusing its external relations upon its neighbours -- Pakistan, Bangladesh, Nepal, China and so on.

In more recent years, India has begun to show evidence of pursuing a maritime strategy. At this stage, no one is quite sure why; even many Indians themselves are unsure.

Actually the basic reason is probably that every powerful country is eventually driven to use the sea. The sea is the one part of the globe that has not been carved up and controlled by nation states. The concept of the freedom of the sea is a vital element in the world order and one of the central historical struggles is between those who wish to control the sea to the exclusion of others, and those who wish to freely use the mobility it confers.

A final comment on geographic determinants of strategic position is that the concept of population density will always constitute an important element. Related to this

is the question of strategic space versus time, the ability to trade off distance for time to gather forces to meet an aggressor.

Australia's population density is low, meaning that it must defend a relatively large area with a small population, in itself a very costly proposition compared with, say, Britain.

On the other hand, because the population is large centred in the southeast, Australia theoretically has a lot of space it can trade for time. It is also protected by some very inhospitable terrain in the desert centre where communications, population and even food and water supply barely exist.

But this is a last ditch position, a solution which only applies when the situation becomes utterly desperate. In my view, if Australia ever got to that point, it would already have been defeated.

### *Economy*

It is a common fallacy, widely suggested to be central to the concept of an isolationist strategy, that Australia is ultimately economically self-sufficient. The view generally arises from the proposition that, even *in extremis*, the population can be fed. It is a simplistic and dangerous notion in the context of national security because it ignores the political pressures that flow from a loss of economic position.

That comment leads to the proposition that Australia's external security cannot be separated from economic considerations. Relations with other countries are increasingly dominated by economic rather than political considerations as the world gets smaller and more interdependent. Thus it is that Australia's economic relationship with Japan and other important Pacific eco-



nomies is more likely to drive her security relationships than the more traditional culturally based relationships with the so-called "white" nations of Europe and, perhaps, even North America.

Most Australians tend to accept that current politics is about economics rather than survival. Government are made or broken on the basis of what they do about the economy. Even if most of them do badly, some do worse than others.

In broad terms, and with the exception of a small section of the community, Australians are relatively well-to-do. They enjoy a high standard of living and expect that to be maintained. The only way they can achieve that is by trading. Australia has what others want; they make what Australians want. So there is an exchange. Stop that exchange -- or interrupt it to the degree that Australians are deprived of what they regard as their birthright -- and there is a real problem. That problem will manifest itself first in things like increased unemployment, financial collapse and the rapid loss of living standards, all of which, in these days, lead to political instability.

If then that problem is coupled with an external assault on Australia, be it political or military or a combination of both, the Australian government has to have the answer or it will be tipped out of office. And if its replacement has no answer, then very strong pressures will build up to surrender to the demands made by the aggressor. In this context, a rich country is more vulnerable than a poor country because it has more to lose. The assault on Australia may well take the form of an assault on its capacity to trade. In my view, a sensible aggressor will actually do it that way. It costs less in both human and financial terms.

## *Historical/Cultural*

Any society is a product of its history and its culture. Even with the geographic and economic factors, it will still tend to respond to circumstances in ways which are derived from its history and culture.

In this context, it is the more optional strategies, especially in respect of those countries chosen as friends and those seen to be actual or potential enemies, that are significant.

As a primarily European and Western nation, Australia's historical experience has led it to a political structure and a culture which respects individual rights and freedoms, which is generally hostile to all forms of authoritarianism and which is strongly oriented to technology. The legacies are not all good; there is also a well-implanted sense of superiority over those we regard as lesser breeds which in turn leads to a misplaced arrogance.

That background, briefly described, has led to a commitment to the western community, especially in the post-1939 global struggle against totalitarianism. The choice offered has been between that commitment and non-alignment. Non-alignment has never really had a chance in Australia for primarily historical and cultural reasons, although geographic and economic factors cannot be ignored either.

A number of prominent Australians are arguing that Australia's migration programme is changing that base, and that is a bad thing. I am not so sure. My own impression is that the pressure for change to non-alignment is coming from the renegade or alienated intelligentsia, primarily westerns and generally people who have been running away from the western value system all their lives.



### *Philanthropic*

There is another element of strategic position which is even more optional. This is what I would call the "good neighbour" element or "look after your mates." This sounds very idealistic and probably more disposable than the others but I would suggest it should not be, that there are very sound reasons why such a policy is in Australia's own selfish interests.

In pursuing a good neighbour policy, there is a strong, even overriding element of *realpolitik*. This is based upon the assumption that such a policy builds zones of peace, interlocking interests which will be defended mutually. This can be seen in two additional ways.

One way of looking at the idea is that by pursuing a good neighbour policy, Australia can expand its strategic space well beyond its own territory. Australia can thus actually expand its strategic geography and become more easily defended. If they are contributing to the defence of others -- as in South Vietnam -- they also are contributing to Australia's.

The second is, of course, that such an extension of mutual interests deters aggression because the target of that aggression becomes bigger and therefore harder to defeat. This is a variation of the old adage that we either hang together or hang separately.

### **Strategic Interests**

Australia's security policy must always be directed to its own interests; first, last and always. The difficulty is to decide what those interests are. Unlike a widely held belief in Australia, it is my thesis that Australia's interests do not end with the beaches. It follows that, when in trying to secure its in-

terests, Australia must engage itself in the Asia-Pacific region. There is simply no choice about that. In geographic terms, that is where Australia is. In economic terms, that is where Australia does most of its business. In philanthropic terms, those are the people to whose security and welfare Australia can contribute.

Only in philosophical and cultural terms is the Asia-Pacific region an alien area and that is a reality Australians must come to terms with because the other realities will not go away.

Despite this, there are still those in Australia who call themselves Australians but who regard their security as essentially tied to the security of Europe and the United States. In fact, that relatively comfortable concept came to an end in 1919 with the emergence of Japan as a vital Pacific power and the concurrent exhaustion of the European imperialist powers.

In my view, it is not too difficult to decide what Australia's basic security interests are provided a hard-headed view of the world is taken. For too long, Australia has tried to avoid taking hard decisions about its security.

Basically, of course, Australian governments must provide for the defence of its population and the basic food producing and manufacturing areas. These are heavily concentrated in the southeast of the continent with a pocket in the southwest. Almost 70 per cent of the population lives in the southeast, an area that accounts for 45 per cent of agricultural production and 80 per cent of manufacturing. This area may be called the last redoubt. Without it, there cannot be an Australia in the accepted sense of the word.



Nevertheless, it is also the least threatened area, well protected by sea and desert from any direct and sustained attack. If it were ever seriously threatened, Australia would, by that time, have lost anyway.

Outside those populated areas lie most of the high value mineral producing areas which now account for a large and growing proportion of Australia's export income, the means by which the community can afford not only the imported consumer goods but also the machine tools, computers and advanced defence equipment which cannot be made economically in Australia. The loss of these resources cannot be afforded so that, even though most lie in lightly populated and environmentally harsh areas, they have to be protected.

Of course, to sustain that trade, Australia must protect the communications -- the ships, the aircraft and the electronic communications systems that transmit wealth. The bulk -- more than 99 per cent by volume -- goes by sea, some 12,000 shipping movements each year. The greater value goes by air, although most of that tends to come in rather than go out.

Protecting communications is a two way road. Australia's trading partners have the same incentive to ensure trade route security. And this is where Australia's old structure of political alliances is not so much falling down as becoming less relevant. The United States is more important now as a source of military equipment, technology and intelligence than as a source of actual military forces. On the other hand, Indonesia's geographic position hard by Australia and lying astride its principal trade routes means that Australian relations with that country are more important than ever.

And this is a central issue. Australia might be nervous of Indonesia. It may see Indonesia as an alien nation with an alien culture. Australians may not like Indonesia's system of government or its occasional ruthlessness in pursuing its own interests. But Australia is not in a position to indulge itself in some fancy flights of morality over corruption or lack of freedom or whatever. After all, Australia's social and political institutions have little enough to be superior about in these areas.

In the same way, Australians can no longer indulge themselves in fits of hostility towards Japan because of what that country did more than four decades ago. Japan is too important to it. There are many people in Australia who are vocally hostile about Japanese war crimes or Japanese investment in Australia.

Most of the anti-Japanese moralists fail to understand how much of their standard of living is owed to the Japanese economy. They have almost no knowledge of the Korean or Chinese impact, or the fact that most of their electrical components and many of our big-name imported cars actually come from Malaysia. Some Australians might not like being so dependent upon imports from Asia but they are not prepared to pay the price in higher domestic costs or reduced security that would result from greater isolationism.

The fact is that the interests Australia has in common with countries such as Indonesia and Japan are so great that the relationships will stand a fair degree of strain. But Australians -- and maybe some in Indonesia -- do need to recognise where their mutual interests lie.

Finally, Australia must also protect its



base areas, those from which it deploys its military forces to protect the national interests. These bases are essentially Sydney, Fremantle and Darwin. I began by outlining the importance of Darwin in the global and regional sense. In a much less obvious way, Sydney and Fremantle play the same role although, of course, they are much less vulnerable.

When Kim Beazley became Defence Minister in 1985, he was perhaps the first Defence Minister in many years to have studied security issues in any depth. Yet he came to office with a conventional conviction that Australia could be defended from the mainland, that preventing lodgements on the Australian mainland by hostile forces was the beginning and end of Australia's national security problem.

He appointed Paul Dibb to investigate the needs of the defence forces to carry out such a strategy and, within those limits, Dibb did a good job.

What became immediately apparent was that the solutions did not meet the problem. As Beazley dug deeper into the problem, he began to realise that Australia's security cannot be separated from that of the Asia-Pacific region. This represented a slap in the face to some of the most treasured beliefs of the Labor Party backed up by the convictions of many of his top military advisers, especially in the army and the air force.

Beazley was eventually persuaded to fight for a rational strategic policy, a policy which, for political reasons, he will not describe as a forward defence policy although, in effect, that is what it is. He has recognised that Australia's security is dependent upon a

secure Asia-Pacific region, especially in Southeast Asia and the South Pacific. He has said so, most notably in his statement on defence co-operation on 23rd February, 1988. He has pointed out that Australia's area of primary strategic interest covers one-tenth of the earth's surface. In Chesterton's terms, he has recognised the problem.

In trying to find the best solution, he and his colleagues have set out to mend relations with such key countries as Indonesia and have moved to fill the gap created by New Zealand's withdrawal from ANZUS. In particular, he has set in train processes designed to build confidence among Australia's friends without making the big waves that would result from an attempt to create formalised security alliances.

What he has done is to create the basis of security co-operation within the Asia-Pacific region which is real but very low profile. It is working and will develop. On the other hand, if it does not work -- and there is a danger of that -- it will be because the concept has not been sold to the Australian community or to the parties which make up their political system. I doubt very much whether it has been sold to all the military or to those groups of intellectuals and journalists and bureaucrats who between them formulate the philosophical bases of Australia's national security policies.

And therein lies a danger. If the key people in the Australian community are unaware or unconvinced that this new/old direction is the right one, then, in a few years, Australia may well again toy with the ephemeral attractions of isolationism because it feels good and because they have forgotten what the problem is.



## Book Reviews

### Indonesia's Perpetual Backwardness

*In the Charm of Prambanan: Indonesia in the Midst of the Global Upheaval* (The Indonesian edition, *Dalam Pesona Prambanan: Indonesia di Tengah Gejolak Dunia*, translated by Hazil Tanzil) by Jan Romein. Jakarta, Grafiti, 1989, 181 pp. This review article by Yohanes Sumadya Widada is translated from *Editor*, June 17 1989.

**T**HIS BOOK comprises a compilation of lectures presented by Jan Romein at the Gajah Mada University, Yogyakarta during the years of 1951-1952. A book which reconstructs historical facts in the light of rethorics.

Hence Indonesia's prominent, Dr. Roeslan Abdulgani in his introductory remarks, comments that Jan Romein's historical view is telescopically evolutionary in nature coloured by optimism regarding the future.

Jan Romein commences by envisaging the awakening of Europe during the Middle

Ages and its impact on Asia (including Indonesia). According to Romein the awakening of Europe is morally not something to take a pride in. On the contrary, as a matter of fact, it was precisely a "deviation of the humanitarian general pattern." This was due to the fact that it had generated an attitude of abusing the reality of society's life pattern at that time. After economic awakening this changed pattern started to be based on motives of gaining profit.

Quoting the view of the economist, Werner Sombart, the textile industry which had developed in Europe was referred to as the basic cause. Ironically, it was precisely this industry that later became established. As a consequence thereof, it exactly led Europe to a "grey period." Social unrests raged. The workers felt being oppressed by the industrialists which -- according to Romein -- were considered dishonest.

And it was from Europe that a dark shadow cast over the world in general. An economic crises hit the world in 1929. "Capitalism clearly proved its incapability," adds



Jan Romein.

However, to what extent has Western capitalistic spirit influenced Asia? Romein provides important notes on this in chapter five. Indeed, there is a difference of principle in the life pattern that occurred in those two neighbouring continents. According to him, the general characteristic of life in Asia today is coloured by a pattern purporting that wealth is used to a greater extent as a symbol of supremacy by the ruling elites. Whereas in the West, wealth constitutes a production asset of industrialists.

Hence, its impact is that poverty in Europe was generated by the immediate exploitation of the bourgeoisie in a production process. Whereas poverty in Asia was caused by the direct exploitation of the ruling elites through the mechanism of forced labour, taxes, or tributes.

That is the Asian model of poverty says Jan Romein. Jan Romein's sociological elaboration will become increasingly clearer when he points out as to why until now poverty still persists to a quite intensive degree in Asia. This, according to Jan Romein, has also some relationship with the West which has as yet got its foothold in Asia.

Asia's advancement will be successful and run smoothly if the region is free from domination by the West (p. 119). Because, to date -- as Y.B. Mangunwijaya puts it -- the economic life of the Third World is overshadowed by the Super Powers.

By virtue of intensive dialogues with several intellectuals at that time -- such as Wonohito from "Kedaulatan Rakyat" Daily Newspaper in Yogyakarta, Soendoro a prominent of the press in the same city, and also

with Sjahrir -- Jan Romein seemed to obtain support in constructing the historical soul and reality which is still developing in Indonesia.

He began to observe signs of apprehension amongst Indonesian intellectuals showing their desire to accelerate Western science. On the other hand they feared to lose their "Eastern" identity. It was this fear that Jan Romein referred to as being ambivalent in reality.

Consequently it has precisely become the problematical centre of Indonesia's history today. Jan Romein places his very critical analysis in the last chapter under the subtitle "The Eagle Hatches. Impressions on Indonesia in the Year 1952." The problem of ambivalence emerged as an uncertainty in the choice between "East" and "West." The objective dualism, which is among other things related to the political dimension, is how to determine one's posture in the 'conflict' between the Russian Bloc and the American one. This has become more obvious in Indonesia's foreign policy.

It is in this respect, that he does not differ much from the anthropologist, Clifford Geertz, who conducted a research in Mojokuto, East Java, during the same span of time. Geertz most popular thesis is related to the concept of *dual society*, a dualistic economy. This thesis has been as yet unshaken. This means that it supports Jan Romein as a telescopic historian who is able to foresee the distant future. That is, the disintegratedness of the traditional economic system with that of the modern one in one whole (integrated) system.

As a consequence, Indonesia's domestic politics is also marked by ambiguity which, according to the author's reconstruction, is



manifested in four kinds of uncertainties.

Firstly, a misconception on the 'independence' era has brought about an extreme reality, namely insecurity in Java. Economic misery, social discontent, landless peasants, unpaid soldiers fighting units, even radical Islamic groups are imputed by Jan Romein as being the major cause.

Secondly, the problem which is less obvious but important, is that on the state structure, i.e. related to the option of centralisation or decentralisation during the Republic era.

Thirdly, is the problem on democracy. A subjective desire to uphold democracy; since the objective reality was not conducive to it, the ideals were realised in a non-democratic manner. According to Jan Romein, it happened not because the government of the

Republic of Indonesia had no authority, but it was due to the fact that the government could not bring its authority to the fore when it was needed. The general election was held when the population were still illiterate.

Fourthly is the economic ambivalence. On the one hand, the majority of the Indonesian people are engaged in an agrarian economic system, they, on the other hand, are also involved in an industrialist-capitalistic economic system.

Why does Jan Romein use the Prambanan Temple as the title of this book? It turns out that Jan Romein identifies the temple as a form of offering to the god Syiwa (the god of life and death). It is in this god that the anti-thesis Asia-Europe should become a synthesis conception. A form of optimism built in the midst of the still unfinished dualism.

## Political Outlook of a Sultan

*Indonesia's Political Framework and Conception* (In Indonesian, *Kerangka dan Konsep Politik Indonesia*) by KGPH H. Mangkubumi, Yogyakarta, Mitra Gama Widya, 1989. This review article by Adi Wicaksono is translated from *Suara Pembaruan*, April 16 1989.

**O**N March 7 1989 last, Yogyakarta recorded a new page in history. The coronation of a new king, Sri Sultan Hamengkubuwono X, was of great signi-

ficance to the Special Territory of Yogyakarta, so that his coronation has stirred Yogyakarta, if not Indonesia.

Not infrequently, the dynastical institution which is aggrandised in an industrial era and sophisticated modern political system is being queried among ourselves. We likewise are suspicious of a dynastical political system which has Javanese culture as its background.

It seems appropriate that this book was circulated at the time of KGPH Mangku-



bumi's coronation as Sri Sultan Hamengkubuwono X, in order to give a response to any question or suspicion directed towards the Keraton Ngayogyakarta Hadiningrat (the Sultan's palace in Yogya).

KGPH H. Mangkubumi, who has assumed the title of Sri Sultan Hamengkubuwono X, attempts through this book, to elaborate on various socio-political and development phenomena, particularly during the New Order period, and the future on the eve of the year 2000. And this book is indirectly a representation of the New Sultan's outlook.

The study in this book takes the political experience approach as its point of departure and has obtained quite a condensed theoretical basis. It is worth noting that the author of this book, aside from being the Chairman of the Regional Chamber of Commerce and Industry (KADINDA) of the Special Territory of Yogyakarta, is concurrently the General Chairman of the Regional Executive Board of the Functional Group (Golkar) of the Special Territory.

The author has accurately presented the parametres around the engineering of the national integration strategy and socio-political reformation process and the continued development of Indonesia.

On the basis of this foothold, this book tries in a specific manner to describe the national and state life dynamics from this cultural perspective, and places great concern in the growth of socio-political institution and its pre-arrangement and development based on Pancasila, in accordance with the challenges faced by the Indonesian State and Nation in all fields of this modernisation era.

Being involved directly in national politics KGPH H. Mangkubumi also plays a decisive role in several Indonesia's National political activities.

The involvement and direct role may assure validity over various important and interesting analyses, views and thoughts on the development and growth of Indonesia's national politics, in the context of Indonesia's development today and in the foreseeable future as well.

Those conception and thoughts have been put forward, both verbally as well as written on various occasions since the early 1980s which are partly included in this book.

The analyses, views and conception presented in this book are preceded by the conception of national integration strategy and concluded with a number of inferences on the perspective of Indonesia's political development on a national scale in the future. Worth noting is the fact that this book, without being light reading, is quite pleasant to read and easy to understand, even nearly all foreign terminologies have been given a sufficiently clear explanation.

Some thoughts which is quite interesting in this book is his apologia for the Javanese "way of life" which is often misinterpreted.

He writes: "The concept of harmony is indeed derived from the Javanese culture, so that the culture has often been blamed for the existence of the seeming harmony. It is time now to straighten it out."

The concept of harmony, which is often used, does have a relationship with the necessary ethics of life in order to suppress the emergence of conflicts. It does, however, not follow that the harmony which is basically only on the surface does not produce real



peace.

Whereas in Javanese culture, the meaning of *tentrem ing manah* (peace of mind) is so significant as peace in the real sense of the word. That kind of peace may be achieved if one is able to create a profound and basic atmosphere of accord and harmony which touches the deepest feelings and man's conscience, and hence, is not only superficial in nature. It is in this sense that accord and harmony should be perceived in the perspective of Javanese culture (p. 21).

As to the issue of national discipline he opines that the concept of national discipline is one which is very important. In view of this importance, all parties should be given the opportunity to give inputs and responses to the development of this conception.

To this end, later on as a consequence, all

political and social organisations should be able to include national discipline in the political agenda of their respective organisations.

Should this happen, and apparently it is most likely to happen, in the perspective of Indonesia's national political development in the nature, national discipline will be ascribed as the most important item in the national political agenda in Indonesia (p. 123).

Some other discussions in this book are indeed non-scientifically academic in nature. This is due to the fact that this book constitutes a compilation of lectures, speeches and papers presented on various occasions. Nevertheless, this book is important as a frame of reference for discussions in which the ideas of Sultan Ngayogyakarta hadiningrat are presented.

## Vulnerability of Our Unity

*Political Integration in Indonesia* (in Indonesian: *Integrasi Politik di Indonesia*) by Nazarruddin Sjamsuddin. Jakarta: Gramedia, 1989. This review article by Octavianus Mote is translated from *Kompas*, July 30 1989.

**T**HE PROBLEM of national integration had not been solved upon achievement of independence by a nation. World national histories have shown how difficult it is to achieve integration. This experience does not only apply to newly in-

dependent countries but it also applies to countries which have been independent for a long time. Those countries, both having ever been colonised or not, have gone through long periods of time to achieve their respective national integration.

Without belittling the significance of political integration achieved at the time of the founding of a state, the fact reveals that people in developing countries are facing serious disintegrative threats not long after their desire for independence has been realised. Differences among the leaders, between the peo-



ple and their leaders, also among the people themselves have brought about conflicts which are not infrequently accompanied by bloodsheds. Those differences, though initially socio-cultural in nature, will become sources of conflicts which are difficult to overcome as they are covered by political interests.

Being one of the newly independent nations, Indonesia has also experienced similar problems. History has proved that the phase after independence (1945-1965) was a very difficult one in achieving national integration. They mostly originated from primordial attachments. According to Clifford Geertz (1963), this primordial issue was centred around matters related to ethnicity, race, language, region, religion and customs. The long history of the Old Order illustrated those diverse conflicts. National integration constituted a very urgent problem at that time. Hence it is not difficult to understand if President Soekarno placed more emphasis on the development of the political concept 'nation building.'

This book also elaborates on the integration issue. According to the author, after the independence, particularly since 1950, the Indonesian nation has been facing the problem of political integration. This is centred around territorial problems and differences between the elites and the masses. Apart from that, differences amongst the political elites themselves eventually generated various problems of political disintegration in Indonesia.

According to the author of this book, political integration is related to at least two things. First, how should one make the people comply with and obey the guidance of the state. Second, how should one step up

the normative consensus regulating the political behaviour of societal members. This is particularly related to fostering consensus among fellow citizens (both the ruling elites and the ruled masses) on the necessary political behaviour in order that the political system may run smoothly (p. 5).

In other words, how should one create a natural equilibrium between consensus and conflict. This ideal equilibrium is reflected in the political system of Pancasila Democracy. (Alfian, 1977). The failure of the government and its citizens in complying with the normative consensus did not only blame integration but constituted a failure of the maturation process of political culture as well.

Reading this book reminds us to another book written by Prof. R. William Liddle, *Ethnicity, Party and National Integration: An Indonesian Case Study* (1970), which perceived national integration as one having two dimensions, the vertical integration dimension and the horizontal one. The vertical dimension purports to bridge the differing perception that may emerge between the elites and the masses. The horizontal dimension purports to decrease the discontinuity and tensions of the regional culture in building a homogenous political society.

If Liddle by virtue of a field research (one year) using local empirical data attempted to answer the question as to how to overcome the problem of national integration, Nazaruddin with more emphasis on literary study (except in the case of the Acehnese movement) stresses more on the factors influencing and determining the said integrational problem.

Using such a theoretical framework, this doctor in Political Science obtained at the



Monash University -- Australia elaborates on three movements (armed movements) that broke out in three regions in Indonesia. Those three movements were the PRRI (Revolutionary Government of the Republic of Indonesia), Aceh Merdeka (Independent Aceh), and Papua Merdeka (Independent Papua Organisation). Apart from that, the Darul Islam case which is another writing complementing this book, constitutes one example of the issue on mentioned political integration.

### **The OPM (Independent Papua Organisation) Case**

Of the four integration cases presented above, it appears that the case of Independent Papua Organisation is interesting to discuss. This case study constitutes a new literary work especially by an Indonesian scholar. Information on the OPM movement has been as yet limited. Aside from foreign researchers, information on this movement has been based on journalists' reports concerning a certain incident, which has thereafter been connected to part of their activities (OPM).

"There is no political integration in Irian Jaya, neither amongst the local indigenous people themselves, nor between them and other ethnic groups of the Indonesian people. This fact has emerged on account of the still low educational level of the people in that region. As a consequence thereof various organised rebellions break out which appears to outsiders as a joint struggle because of the similarity of their goals" (p. 108). This is the writer's conclusion. This conclusion calls for our further discussion.

The development of Education in Irian

Jaya has grown rapidly under the Government of the Republic of Indonesia, particularly under the New Order government (Chris Manning and Ross Gernaut, 1979). Owing to the growth of the said education, political socialisation too has been growing, either through formal or non-formal education.

The network of transportation has increasingly been opened, communication and social interaction have also increased. The said political socialisation has changed the political perception of the people of Irian Jaya. It is no longer as it used to be in the 1960s. Hence using education as the criterion of political integration is as a matter of fact not quite appropriate. This criterion would be more appropriate for the years 1970 and before.

As long as one uses the political approach in studying the integration issue, one will also not be able to explain various social movements emerging in this region. Those movements may be based on political motives, but they may also be based on other motives such as the millenarist movement (John G. Strelan, 1989), or movements that emerge as the consequence of the excesses of development which is still actively being carried out.

Based on the thoughts presented above the problem of integration lies in how the development is being carried out in this region. Is the development model appropriate and does it concern most of the people there? Do the implementors of development act as servants of the state and render their services to the society or is it the reverse? Perhaps this latter factor is very decisive to the common people in the village. The society look upon them as the reflection of the concept of the



Indonesian state. If the implementors of development perform properly, their perception on this nation will also be proper and the other way round.

This is understandable in the sense that the OPM idea itself has in fact been inculcated by the Dutch as aforementioned in this book. It is not created by the people of Irian Jaya themselves. Hence the answer of the political integration issue lies in the implementation pattern of regional development. The programme has to value the peculiarity of this region so that the population will not feel strange and frightened in their own region, but will be able to develop themselves through interaction with other people. They will feel being protected by the civilian or military government and not the opposite.

This book is a literary study based on a number of writers a few years ago, hence one feels the inappropriateness of the data compared with the current situation. This is at least obvious from the case of James Nyaro.

OPM's President in Irian Jaya who is still being referred to as a leader in Irian Jaya (p. 107). Whereas in fact, he together with Donland Dery has asked for political asylum through Papua New Guinea to a third country in 1985 (*Kompas Daily*, 3-5-1985). Accordingly, drawing conclusions by relying only on secondary data is bound to call for further discussions. The more so if the conclusion is used as a criterion of the current situation, which has certainly changed.

This book is certainly not intended to become an indepth study on the movement itself. However, it is able to reveal a problem which among certain Indonesian circle in Irian Jaya has as yet been considered as a bogeyman which tends to be diplomatised.

However, by and large this book reminds us again on the vulnerability of the integration issue of Indonesia, as a consequence of the lack of both vertical and horizontal integration.

## A Witness from India

*Trace of the 1945 Revolution, a Historical Witness* (in Indonesian, *Jejak Revolusi 1945, Sebuah Kesaksian Sejarah*) by P.R.S. Mani. Jakarta, Pustaka Utama Grafiti, 1989, 192 pp. This review article by Roeslan Abdulgani is translated from *Tempo*, August 12 1989.

**A** WITNESS ACCOUNT by an Indian Journalist on Indonesia's physical revolution. Many things which were unknown before have now been

revealed. A review article by Dr. Roeslan Abdulgani.

This book is a very interesting one, especially for those of my age group who has experienced the past historical period of the physical revolution following the 1945 Independence Proclamation.

The writer is an Indian national who witnessed that historical period, but who also made contacts and was involved in political and spiritual dialogues with its actors



and protagonists, particularly with Bung Karno, Bung Hatta and the Little Bung Syahrir.

The influence of those three revolutionary prominents has made a deep impression on Shri Mani's personality, namely, Soekarno with his charisma, the quiet and polite Hatta with his intellectual aptitude, Syahrir with his analytical and keen thoughts. The three are described by Shri Mani as the triumvirate who were able to arouse a spectacular preparation for the revolution under the Japanese Military Power.

Shri Mani writes: "Soekarno cautiously fanned the revolutionary spirit. Hatta used his position with the Japanese government to maintain it in disguise. And Syahrir organised and directed the revolutionary spirit along with the faithful groups of students in support.

Shri Mani's observation is basically not incorrect. Indeed during the Japanese period and during the epilogue and prologue of the Independence Proclamation, the role played by the aforementioned prominents was really felt amongst the younger generation of my age group at that time.

This book is not a scientifically historical one, but a historical feature written by a journalist who became a young Indian diplomat who is accurate in his observation. He is also able to express the fruits of his observation in substantial and humane commentaries.

Shri Mani is an observer, full of sympathy to our independence revolution. Hence, this book has some degree of subjectivity, however it does not deviate from its objectivity. Indeed any historical observance will not be 100 per cent objective. Some degree

of subjectivity will be mixed with some degree of objectivity. Those that are important are truthfulness and sharpness of the eyes and heart and not blurry bias against facts.

There are indeed some shortcomings here and there. For instance with regard to the battle in Surabaya during which Shri Mani, along with British and Gurkha prisoners of war was imprisoned in the Kalisosok prison, but who was later released.

Apart from the fact that Shri Mani's description only covers a part of the battle front i.e. in Surabaya, he also thinks that the East Java Governor was Mustafa (Mustopo) in fact the East Java Governor then was Surio. Also with regard to the Indonesian delegation who in April 1946 went to the Hoge Veluwe in the Netherlands led by Mr. Suwandi, the then Minister of Justice with the then Minister of Home Affairs, Dr. Sudarsono and the then State Secretary, Mr. Abdulkarim Pringgodigdo as member, is described by Shri Mani as though Syahrir went there.

This inaccuracy is just a minor error and does not diminish the value of the book on the whole which reflects the authors witness which is full of philosophical, political, historical and cultural contemplation on the revolutionary struggle of our nation in defence of the Independence Proclamation.

This contemplation is based on Indian philosophy. He, for instance, sees in the person of Bung Karno the influence of Bhagavat Gita (Vedanta) and other sources of Indian philosophy, although Bung Karno tapped thoughts of Western philosophies and protagonists. This also applies to Hatta and Syahrir.

The basic thoughts on the trilogy: "National Spirit, National Will and National Ac-



tion" during Dutch colonialism, thought on "Bhinneka Tunggal Ika" (Unity in Diversity) and "Pancasila" (the Five Principles) on the eve of the Proclamation of Independence by Bung Karno, receive invaluable positive response in this book.

Also the relationship between Indonesia and India during the physical revolution is specifically analysed, among other things concerning Indonesia's offer of 500.000 tonnes of rice to India by the then Prime Minister Syahrir in April 1946 to alleviate famine stricken India which broke through Dutch blockade. Also regarding Bung Hatta's incognito visit to New Delhi to meet Nehru in August 1947. Besides, also Nehru's invita-

tion to Bung Karno to visit India in December 1948 which failed due to the Dutch invasion of Yogya, international mobilisation by Nehru during that invasion and other accounts the details of which were not so known by us.

Looking at all these, this book is worth reading by the present younger generation, by those who desire to obtain a thorough comprehension of our struggle in the defence of our Independence Proclamation and to realise the quality of our leaders, in particular, the Triumvirate Soekarno-Hatta-Syahrir. Their later crack among them during the following phases of our revolution does not a bit diminish the beauty of the role this Triumvirate played then.



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